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THE SALE OF CONRAIL

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

THE ANTITRUST IMPLICATIONS OF THE SALE OF CONRAIL TO NORFOLK SOUTHERN

MARCH 27 AND APRIL 2, 1985

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THE SALE OF CONRAIL

WEDNESDAY, MARCH 27, 1985

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 10:04 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Present: Senators Biden, Specter, McConnell, Simon, Mathias, Leahy, Byrd, and Grassley.

Staff present: Kenneth Starling, counsel for antitrust; Ralph Oman, Terry Campo, Deborah McIlroy, Jan Walker, Cinthia Lebow, Melissa Wolford, Stephen Ross, and Laurie Westley.

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The committee will come to order.

Today's hearing is on a subject of great interest to the members of this committee and to the public at large. We are meeting today to consider the Department of Transportation's proposal to sell the Consolidated Rail Corporation to Norfolk Southern Corp. This proposal involves significant antitrust consequences because Norfolk Southern and Conrail are direct competitors in a substantial segment of the country.

Our purpose in conducting these hearings is to review those antitrust implications of the sale. Antitrust law compliance and enforcement are very important issues within the jurisdiction of our committee. I sought to have the legislation which authorized the Conrail sale referred to the Judiciary Committee so that we might fully consider the antitrust issues. While I was unable to have the bill referred, I did reach an agreement with Senator Danforth, the chairman of the Commerce Committee, that the Commerce Committee would not act on the legislation until our committee had an opportunity to review the antitrust aspects of the sale.

Therefore, this committee is holding 2 days of hearings on this matter. Our second day of hearings will be on April 2. This schedule will allow the committee to meet on April 4 to discuss the matter and decide on any recommendations this committee might wish to make.

Consolidation of two major railroads that compete directly raises substantial antitrust concerns. The Department of Justice has reviewed the effects of this merger on competition. The Justice Department informed the Secretary of Transportation that the merger appears to be anticompetitive in some respects, but procompetitive and beneficial to consumers in other respects. The Justice

Department has said that it would have to oppose the sale to Norfolk Southern on antitrust grounds unless certain competitive problems are resolved.

However, Justice has proposed a divestiture plan to solve many of these problems. Our purpose in these hearings is to inquire into the competitive aspects of the sale, to review the application of the antitrust laws, and to examine the nature of any antitrust immunity conferred by this transaction. We are seeking to aid the Senate in doing what is best for the Nation, for competition and antitrust policy, and for citizens and consumers.

We have a most distinguished group of witnesses for our hearings. In setting up the hearings we have tried to accommodate all requests from Senators and to provide them with all the needed information. Today we will hear from two of our distinguished colleagues, Senators Specter and Heinz.

We will then hear from the administration officials who are involved in the proposed sale beginning with Mr. McGrath from the Justice Department Antitrust Division. We have also asked witnesses from the Departments of Transportation and Treasury to join us so that our members can obtain a complete picture of the transaction at issue. Next we will hear from the proposed purchaser, Norfolk Southern, and then we will receive testimony from the companies seeking to buy the assets that will be divested.

Following them we will have three witnesses from railroads who are opposed to the sale. At our next hearing we will hear from shippers and port authorities about the impact of the merger on competition in their markets. I look forward with great interest to the testimony.

Now, we have a lot of witnesses and we are going to ask these witnesses after we have opening statements by the members of the committee, we are going to ask these witnesses to agree to put their entire statements in the record so it will be available to all Senators and to the public, but to limit their remarks to 5 minutes. By doing that we can arrange to give everybody the opportunity to be heard. Otherwise, some would be denied that opportunity.

Our first witness this morning is—we can call his an opening statement or we can call it testimony, whichever you wish, because he is a distinguished member of this committee.

Senator SPECTER. I would prefer to call it an opening statement, although I shall take the witness box, considering the fact that witnesses are limited to 5 minutes, and opening statements are not. [Laughter.]

The CHAIRMAN. Well, how long is your statement?

Senator SPECTER. Not too much over 5 minutes.

The CHAIRMAN. All right. We will now hear from the distinguished Senator from Pennsylvania and a member of this committee, Senator Specter.

STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. At the outset, Mr. Chairman, Senator Thurmond, I commend you for your diligence and persistence in calling for and scheduling this hearing. I must say that I am at a loss as to the parliamentary rules which do not give this committee jurisdiction as a matter of right to this issue, considering the very important and far-reaching antitrust implications of the proposed sale—a subject matter on which the Committee on the Judiciary has exclusive jurisdiction.

I am also at a loss to understand the interest in rushing to judgment on this very momentous sale which has such tremendous ramifications for the public welfare. On the Senate floor, when you sought a referral my distinguished colleague, Senator Heinz, pressed the chairman of the Commerce Committee for assurances that this issue would not be taken up in reconciliation as a shortcut procedure. Those assurances have not yet been given. Only two brief hearings have been held before the Commerce Committee, notwithstanding the interest of some members there for more extended hearings.

We face very, very complex considerations which are hard to digest in the course of the very brief hearings which have been scheduled by this committee, and by the Commerce Committee.

I have studied this proposed sale in some substantial depth initially because of my concern about the consequences to my State, Pennsylvania, which stands at risk of being pillaried—with a loss of jobs, since there are 15,000 Conrail employees in Pennsylvania, with a limitation on service to some 2,300 shippers, and with the loss of very important repair facilities in Hollidaysburg, Altoona, and Conway.

Also at risk are the corporate headquarters in Philadelphia, and substantial shipments through the Port of Philadelphia, where Conrail currently ships coal at $4 a ton less than Norfolk. I have investigated this matter in a series of hearings in Pennsylvania, and through the Northeast-Midwest Coalition in Washington, DC. I have concluded that there are grave national consequences to this sale because it brings together two enormous railroads: Norfolk Southern with 18,000 miles of track, and Conrail with 15,000 miles of track—affecting commerce in some 21 States, 100 markets, and 5,557 terminals which will be served by only one railroad.

The law on the subject of rail mergers has been set out at some length in the decisions of the courts of this country.

In a landmark case which still has great vitality, although the Supreme Court decided *U.S.* v. *Union Pacific Railroad Company* back in 1912, the Court declared a purchase by Union Pacific of 46 percent of the stock of Southern Pacific an illegal combination, and a restraint of trade. In so holding, the Supreme Court said:

> . . . a combination which places railroads engaged in interstate commerce in such relation as to create a single dominating control in one corporation, whereby natural and existing competition in interstate commerce is unduly restricted or suppressed, is within the condemnation of the Sherman Act.

In 1922, a decade later, the Supreme Court, in *United States* v. *Southern Pacific* again held against a combination and said this:

> These two great systems are normally competitive for the carrying trade in some parts from the east and middle west to the coast, and for the traffic moving to and from central and northern California . . . such combinations . . . resulting in the unified control of different roads or systems, naturally competitive, constitute a menace to, and a restraint upon, that freedom of commerce which Congress intended to recognize and protect, and which the public is entitled to have protected.

This language which very well applies to this proposed sale, which is a menace and a restraint on freedom of commerce.

More recently the language of the Clayton Act is applicable to this situation. In the 1964 decision of the Supreme Court in *United States* v. *Alcoa* the Court reversed an effort at merger, and said that "in the Clayton Act," Congress used the words 'may be substantially to lessen competition' to indicate that its concern was with probabilities, not certainties . . . mergers with a probable anticompetitive effect were to be proscribed by this act."

Mr. Chairman, and members of this committee, I believe that the underlying facts here show that there is a very anticompetitive effect. In the legislation which has been proposed, there has been a provision inserted which would grant antitrust immunity—which is highly irregular and really unprecedented, the NERSA situation having no relevance to this kind of a situation.

The legislation submitted carries a provision that the sale be deemed to have been approved by the Interstate Commerce Commission, which constitutes a complete legislative antitrust immunity without a prior public hearing. The proposal would completely bypass the ICC's procedural and regulatory safeguards, including the opportunity for evidentiary hearings, with full public notice and disclosure.

I would suggest, Mr. Chairman, to this committee, and to the Senate and to the Congress, that this is really very, very surprising, given the elongated proceedings, and the very incisive analysis of the Interstate Commerce Commission, to have that bypassed and to try to rush through to judgment on this matter.

I read the Justice Department antitrust letter, Mr. Chairman, to be a very strained interpretation of compliance with the antitrust laws. They are really sticking an elephant through a funnel here.

In writing to the Department of Transportation, the Antitrust Division says that "We have concluded that without appropriate divestitures the proposed merger would violate both Clayton Act and Interstate Commerce review standards." Yet no appropriate divestiture has yet been set forth.

The Department of Justice went on to say that, "The Department of Justice, therefore, would oppose the proposed merger unless its competitive problems are remedied through a prior or concurrent divestiture of assets that is approved by the Department of Justice."

The Department of Justice, on page 8 of its letter, called for the kind of divestiture which would resolve at least $371.4 million of potential problems out of a total of $516 million. But Norfolk Southern, in the testimony of its president, concedes that they are only having divestitures in the $100 million range.

The kinds of divestitures which have been proposed are totally insufficient. They propose selling branch lines to small railroads which do not have the vitality or strength to carry on any sort of competition. It is therefore anomalous that the Secretary of Transportation has said that this sale is necessary because of the uncertainty of the future of Conrail—a company which made $500 million last year, and if taxed at customary rates, would have made $235 million.

Yet under the proposals of divestiture, there would be sales to railroads like Pittsburgh & Lake Erie, which lost $11.6 million in its last full fiscal year, and the Delaware & Hudson Railroad, which is the sole connection between Guilford's New England system and the divested lines. That system posted losses every year in the last decade, including a loss of $16.3 million. We will have an opportunity during the course of these hearings to examine this issue in full—the proposed divestitures simply do not make commercial sense in terms of providing competition to other lines.

Mr. Chairman, I ask unanimous consent that the full text of my statement be included in the record. I have only summarized certain highlights here.

The CHAIRMAN. Without objection the entire statement will go into the record.

[Statement follows:]

Statement of
The Honorable Arlen Specter
U.S. Senator -- Pennsylvania

Concerning the Sale of Conrail and the Need to Preserve Rail Competition Before the Senate Committee on the Judiciary

March 27, 1985

Introduction

Mr. Chairman, and Members of the Committee, I appreciate this opportunity to testify on the proposed sale of Conrail, which is of vital interest to my State, the Commonwealth of Pennsylvania, as well as to the entire Country.

I have been concerned about the proposed sale of Conrail since June of 1984, when proposals were finalized and submitted by three private bidders. I feared that these proposals had potentially disastrous consequences for my state, the Commonwealth of Pennsylvania. During the last eight months, through exhaustive analysis, I have become convinced that a sale of Conrail to the Norfolk Southern Corporation will have disastrous consequences, not merely for Pennsylvania, but for the entire Nation.

Accordingly, on February 19 of this year, I introduced two bills intended to forestall such a calamity. The first bill, S. 464, blocks the proposed sale of Conrail to Norfolk Southern. The second bill, S. 465, provides that, in the event that a sale of Conrail is deemed advisable at this time, it shall proceed by a public stock offering, and not by a private sale.

I reached my conclusions regarding the proposed sale to Norfolk Southern as a result of a lengthy and detailed process, which included extensive consultations with labor and business leaders, both within Pennsylvania and outside of my State; numerous discussions with the Secretary of Transportation, Elizabeth Dole; review of voluminous documents; and seven hearings that I have conducted on this subject. At these hearings -- in Harrisburg in October, Philadelphia in December and March, Pittsburgh in January and February, and (along with Senator Dixon of Illinois, my Co-chair on the Northeast-Midwest Senate Coalition) in Washington, D.C. in January and February -- I heard the testimony of more than 55 witnesses, including shippers, public officials, competing bidders, investment bankers, union leaders, and Conrail management and financial officers.

I believe the record of these hearings compels the conclusion that it would be strongly contrary to the national interest to proceed with the proposed sale of Conrail to Norfolk Southern.

Secretary Dole's conclusion that competition will be preserved in the region now served by Conrail, notwithstanding the proposed merger, is simply incorrect. While I applaud Secretary Dole for her sincerity, I reject both her analysis of the facts and her conclusions as to what is best for the United States. A Norfolk Southern/Conrail merger will substantially reduce rail competition.

Competition on Parallel Lines

Today, Conrail and Norfolk Southern actively compete. Indeed, they have more than 1,200 miles of parallel trackage throughout their systems. The proposed sale would combine Norfolk Southern's 18,000 miles of track with Conrail's 15,000 miles of track. The resulting entity would be the Nation's largest railroad. The new, combined system would enjoy more than 50 percent of the Nation's rail markets for chemicals, grain, metals, motor vehicles and equipment, and scrap. With a fleet of 259,000 freight cars, 6,000 locomotives, and a combined annual revenue of almost $7 billion, this mega-railroad would dominate rail transportation in the Northeast-Midwest, and have extremely adverse effects on competition within the national railway system.

During 1984, over $50 million in Conrail revenue was generated from traffic on the parallel lines served by both Conrail and Norfolk Southern. The geographic scope of this competition is vast, encompassing rail traffic in Illinois, Indiana, Maryland, Michigan, Missouri, New York, Ohio, Pennsylvania and West Virginia. Conrail generated an additional $223 million in rail revenue in 1984 from lines currently benefitting from "origin competition" between Conrail and Norfolk Southern, and over $224 million from lines currently benefitting from "destination competition" between the two railroads. In the event of the proposed merger, this $500 million in annual rail traffic would lose the benefits presently provided by competition.

The magnitude of the threat to competition is further apparent when one considers that the combined rail system would have approximately 60 percent of the rail market in Michigan, 95 percent of the market in northeast Indiana, 70 percent of the southern Michigan steel traffic, 85 percent of the Cleveland grain traffic, and 94 percent of the eastbound New England/New York/Texas corridor rail traffic.

The Department of Justice Report

The Department of Justice, in its January 29 report to Secretary Dole, concluded that the merger of Norfolk Southern and Conrail will have a "very serious anticompetitive effect." The report further states that:

> The merger would have a significant adverse effect on competition for the transport of commodities to and from a number of locations in several states, with the greatest adverse effect occurring at locations along an east-west rail corridor running between Buffalo and Pittsburgh in the east and St. Louis and Chicago in the west. The merger would likely enable the merged entity to achieve certain efficiencies. These efficiencies do not appear, however, to be sufficiently great to offset all of the competitive effects in all of the affected markets. (DOJ Report, at 1.)

Justice identifies "more than one hundred markets located in 39 counties in 21 states" which would suffer significant anticompetitive effects as a result of the proposed merger.

The Justice report, moreover, represents only a partial consideration of the anticompetitive aspects of the proposed merger. It wholly ignores, for example, the impact on the area east of Buffalo, Harrisburg and Philadelphia. It also greatly underestimates the extent of the antitrust problems, by failing to recognize the consequences of abandonment of lines by other carriers, which would be likely to result from the proposed merger. CSX Corporation, for one, has testified that it would likely have to abandon lines that are now in service.

The divestiture remedy suggested by the Department of Justice is insufficient to prevent a dramatic loss of geographic competition. The small carriers who would acquire the divested lines would carry low density traffic on marginally profitable lines. They would not provide meaningful competition to the high density traffic carried by the merged Conrail/Norfolk Southern system. Further, these smaller carriers originate at most, only one-twentieth of the volume of carloads that would be originated by the combined Conrail and Norfolk Southern, and generate only one percent as much income. It is extremely unlikely that these potential acquirers would be able to withstand the challenge of the proposed merged system in the long run. Accordingly, they cannot be relied on to provide the long-term, viable, competitive rail service mandated by the Department of Justice.

Ancillary Anticompetitive Effects

In addition to its direct anticompetitive effects, the proposed merger also would inhibit competition for the routing of rail traffic between points served by Conrail or Norfolk Southern and points in other parts of the country. At present, traffic between such points can be routed via a number of railroads in the South, Southwest or West. With Conrail as an independent carrier, shippers are free to select from a variety of interline options. A shipper in a Western state, sending freight to an upstate New York destination served by Conrail, can route its traffic via Chicago or St. Louis, along the lines of the Chicago & North Western, the Burlington Northern, the Union Pacific/Missouri Pacific, the Santa Fe, or the Southern Pacific. Similarly, for a rail shipment from a point in the Conrail service area to the Southwest or the South, a shipper can use any of several railroads, depending on the paticular destination. This promotes competition among the carriers, and allows a shipper to select the routing option that it deems most attractive in terms of rates and service.

In the event of a merger, however, 5,557 stations would be served by no other than Conrail/Norfolk Southern. A combined Norfolk Southern/Conrail reasonably could be expected to prefer its own long-haul routes. Because the merged system would be considerably expanded geographically from the Canadian Border to the Gulf of Mexico, and from the East Coast to as far west as Kansas City -- routings via other connecting railroads would be curtailed or eliminated. Competition will unavoidably be reduced, and carriers weakened so seriously that reductions in their operations might result. Because Conrail serves so many Northeast points exclusively, the merged carrier would be able to assert enormous leverage in its routing practices. The net effect of this process will be to enrich the merged system at the expense of rail workers, shippers, and thousand of local communities across the country.

The Special Consequences For the Northeast and Midwest States

Although the impact of the Norfolk Southern/Conrail combination will be felt throughout the Nation, it is the industrial heartland of the Northeast-Midwest that will be most directly affected. The merged carrier will be the dominant, and often the only, railroad in many parts of this region.

Although a broad array of industries will be affected by the proposed merger, the most pronounced anticompetitive effects will be experienced by those industries that depend heavily on rail service for the products they use and/or ship. The following eight products or industries come within this category: steel; autos and auto suppliers; chemicals; coal production; electric utilities and other coal consumers; machinery and appliances; paper; and construction materials.

These industries, which are at the heart of the Northeast-Midwest economy, already face immense economic challenges and are hard-pressed in their battles for survival. The price they pay for the transportation of goods they consume and produce comprises a large share of their costs. Accordingly, the reduction in competition as a result of the proposed merger is an acute threat to the financial viability of these industries.

It is, of course, not just the manufacturing sector of the Northeast-Midwest economy that will be adversely affected. Railroads move huge volumes of grain, and Conrail and Norfolk Southern -- whose lines overlap through the rich agricultural areas of Ohio, Michigan, and Indiana, and whose separate routes extend into Missouri, Illinois, and the South -- are significant competitors for this grain transportation traffic. Likewise, they compete for the transportation of processed foods and other consumer goods. Reduction in competition as a result of the proposed merger would thus injure farmers and the ultimate consumers of agricultural products.

The anticompetitive effects in the Northeast-Midwest of joining Norfolk Southern and Conrail also extend beyond those areas in which direct competition between the two would be eliminated. Many additional counties in Illinois, Indiana, Michigan, New York, Ohio, and Pennsylvania would suffer a near-monopoly because Norfolk Southern and Conrail together account for the preponderance (60 percent or more) of rail traffic into and out of these locations. When the counties in which Norfolk Southern and Conrail are the dominant rail carriers are added to those in which Norfolk Southern and Conrail are the only railroads, 50 counties would sustain a substantial reduction or elimination of rail-to-rail competition in the event of a Norfolk Southern/Conrail merger. The affected traffic in 1983 in these 50 counties was massive, totaling almost 100 million tons.

The effect of the proposed merger on coal traffic is illustrative of the disastrous consequences that would result from the loss of Conrail as an independent, innovative competitive railroad. In 1984, in order to expand its export coal business and create an export market for high sulfur coal, Conrail developed a program to blend the low sulfur coal from mines it serves in West Virginia with the high sulfur coal from mines it serves in Pennsylvania. Conrail lowered its rates on the West Virginia coal, and blends the two types of coal at its piers at the Philadelphia Port. A $42 million investment was recently made at the Port in order to triple its coal handling capacity. The resulting blended coal meets the quality requirements of the export market, and creates an entirely new market for Pennsylvania coal mines.

If Conrail and Norfolk Southern merge, however, the combined system would have little incentive to serve the interests of the Pennsylvania coal mines and to further develop the newly created markets. Low sulphur coal hauled by Norfolk Southern from Kentucky and West Virginia and exported at Hampton Roads, is so plentiful and inexpensive that the merged system would not likely make special efforts or concessions to promote Pennsylvania coal.

Conclusion

At hearings which Senator Dixon and I co-chaired for the Northeast-Midwest Coalition, CSX Corporation vowed to file suits under the antitrust laws to prevent the proposed merger.

Such litigation might last for more than a decade. Thus, even if the proposed sale is approved by Congress, the courts will be the final arbiter of the issue whether the merger violates our Nation's antitrust laws, in the absence of a grant of antitrust immunity to the proposed sale -- an alternative which clearly cannot be allowed. I firmly believe that the proposed sale of Conrail to Norfolk Southern would violate those antitrust laws, and that our Federal courts -- after great expense and many, many years -- also would so conclude. We in Congress can avoid the confusion, expense and delay of such massive litigation by rejecting the disastrously anticompetitive proposed merger. The National interest in a competitive rail system demands no less.

Thank you.

Senator SPECTER. I would conclude by saying that this proposed sale has enormous ramifications for major industries in this country, which will be paying higher prices. It seems to me that we ought not to rush to judgment—that there is no emergency situation to have a markup in the Commerce Committee on April 10 or April 18. If the expression "railroaded" had not been coined years ago as a definition for unseemly haste and injudicious treatment, this proposed sale of Conrail to Norfolk certainly would have resulted in the coining of that term "railroaded."

I am glad that this matter will be before our committee, and I appreciate the opportunity for this opening statement, Mr. Chairman. I will have further things to say during the course of the questioning. I thank the committee, and I thank the Chair.

The CHAIRMAN. Thank you, Senator. You can come back up and resume your seat on the committee now.

The distinguished Senator from Ohio and a member of this committee.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. Mr. Chairman, I have long been an advocate of full employment and have actually introduced legislation known as full employment bills, and I am glad that this piece of legislation is before Congress today because it certainly has contributed to the full employment for Washington lobbyists.

Every year we get a bill that brings out all the lobbyists. We had one on the Bankruptcy Act; they were here on all sides. We had one in connection with natural gas decontrol, and somehow we find a way to keep the lobbyists in this community fully employed and this bill is just that kind. I think it is fair to say we will probably before we get done make them earn their money because I think this bill has a rather tortuous road ahead of it.

I want to begin today by expressing to the chairman my appreciation for his efforts on the floor of the Senate to see to it that this committee have its rightful jurisdiction in connection with a matter having such strong antitrust implications as does this one.

And as always, the chairman has been most gracious in responding to the concerns of the members of this committee and maintaining that point on the floor of the Senate.

Thus far the debate on the proposed Conrail sale revolved around a single question: how best to divest the Federal Government of its interests in the railroad business. Some, including the Department of Transportation favor a negotiated sale of Conrail to the Norfolk Southern Railroad.

I would like to doff my cap to the distinguished Secretary of Transportation who I think has gone as far as any single human being could possibly go in attempting to interpret the position of the Department of Transportation and making herself and the members of her staff available for discussion purposes.

Others would prefer selling Conrail through a public offering of some kind, but there is another question and one that I intend to raise today, and that is quite simply the question of why we should be selling Conrail at all, and if we should be selling Conrail why should we be selling it for $1.2 billion.

Conrail today is a money making proposition. It has been a money making proposition since 1981. Last year it earned over $500 million. In 1983 it earned $313 million, and in 1982 it earned $174 million, and in 1981 it earned $39 million.

It currently has in the bank over $800 million in cash. And the moment the purchaser moves in it buys—for $1.2 billion—$800 million in cash plus all of the assets of Conrail. In addition to that it has $250 million in excess pension funds that are actually sitting there in the bank at the moment. In 1985 Conrail predicts it will earn a profit of $414 million, and in the next few years there is every reason for confidence that Conrail will begin to retire, amazingly, to pay back to the U.S. Government some of the money it owes it, $850 million in long term debentures.

In other words, Conrail is a very substantial asset, an asset in which the taxpayers of this country have a $7 billion investment. To sell it for $1.2 billion and to give the buyer all the governmental guarantees that are provided in this agreement, if passed, I believe will cause historians to look back and call this the great railroad steal of 1985.

To sell this property with all of its assets, with all of its tax advantages, with all of the Government guarantees and to get $1.2 billion is a total absurdity in this Senator's mind.

But putting aside those economic considerations, I want to point out that Conrail is a vital asset to the Northeast and Midwest regions of the country. Over the past 4 years, for example, Conrail has taken business away from every other rail carrier in the region. They make money the old fashioned way. They offer lower prices and better service.

And I fail to see how the DOT's plan to dispose of Conrail serves the interests of the Northeast and Midwest or the taxpayers of this country. What do we get in return for the Federal interest in Conrail if it is sold? Among other things, as Senator Specter has pointed out, thousands of railroad workers in his area and my region of the country will lose their jobs. How many? Arguable. According to Conrail Chairman Stanley Crane the number of lost jobs will run between 4,000 and 8,000.

Norfolk and Southern has announced its intention to eliminate at least 1,200 redundant employees. But whether it turns out to be 1,200 or 4,000 or 8,000 the numbers are substantial. And what else: in addition to costing thousands of jobs in the Northeast and Midwest, the proposed sale would substantially reduce rail competition in the region. Combining the Norfolk Southern and Conrail systems would produce a carrier of unprecedented size and power. The new system would control nearly 50 percent of the tonnage and nearly two-thirds of the freight rail revenues in the region. That is a dominant position, the kind of position that inevitably encourages arbitrary rate increases and destroys a company's incentive to provide timely and efficient service.

Put any corporation in this country in a dominant position in its industry and the community and the public is not going to be that well served. I am not alone in my concern about the impacts of the proposed sale on competition. After 6 months of study the Antitrust Division of the Justice Department concluded that a sale of Conrail to the Norfolk Southern Railroad would "have a significant adverse effect on competition."

The Department then announced it would oppose the merger "unless its competitive problems are remedied through a prior or concurrent divestiture of assets" owned by Conrail and/or Norfolk Southern. Now, on the surface that looks positive. But, unfortunately, it leaves open the question of what will be divested and to whom.

Norfolk Southern is currently negotiating for divestiture with two railroads, Pittsburgh & Lake Erie and the Guilford system. These are not, to put it mildly, powerful competitors. The Pittsburgh & Lake Erie has not in recent years made a profit. The company lost $11.6 million last year, $23.5 million in 1983, and $12.6 million in 1982.

The Guilford system, which lost $29.8 million over the past 3 years was able in 1984 to make a profit of $2.8 million. That was a positive sign. But it was also the first profitable year in the company's history. These are two railroads that somehow are supposed to compete with the combine of Conrail and Norfolk Southern that together earned $982 million in 1984.

And consider this: the administration argues that while Conrail may be profitable today it is not in the long run a strong enough corporation to survive on its own. But if Conrail cannot stand on its own I shudder to think about the future of Pittsburgh & Lake Erie or the Guilford system.

Now, how do the taxpayers fair in all of this? If the Department of Transportation proposal is allowed to stand, the Federal Government will receive $1.2 billion for an asset in which we have an investment of $7 billion. A bad deal? Yes. But, frankly, the low price is only part of it. The deal also includes forgiveness of $850 million in debts owed by Conrail to the U.S. Treasury. Now, I should point out that the Department of Transportation and others claim that the cancellation of Conrail's $850 million debt "was not an invention of the Department of Transportation; it was mandated by Congress in 1981 to give the newly privatized Conrail a fighting chance at survival."

That comes from the Department of Transportation fact sheet. My staff advises me that they were unable to find any such provision in the law. And I have asked Norfolk Southern lawyers to cite the section of law and so far they have been unable to do so.

In addition, if the transaction goes through, Norfolk Southern stands to gain $3 billion in tax writeoffs. Those writeoffs ironically enough arise from deductions generated by past investments in Conrail, investments of Federal dollars.

And if there ever was an unbelivable situation, this is it. The Federal Government put in $7 billion. The assets of Conrail are now valued at $3 billion. We do not get back our $7 billion. We get $1.2 billion back, and the new buyer is permitted to deduct the $3 billion in future years, $435 million in 1985, $396 million in 1986, $383 million in 1987, $371 million in 1988, $379 million in 1989, and $395 million in 1990. And I did not carry the figures out further. So we put in $7 billion. We get back $1.2 billion. And then we permit the new buyer to get a reduction on its taxes to the extent of $3.2 billion.

Now, the fact is that the Department of Transportation addressed themselves to this issue. Let me point out what the issue is: Whether or not a corporation can transfer corporate tax writeoffs by filing a consolidated return. And the answer is yes. Now there is a separate limitation rule, the so-called built-in deduction rule, for filing consolidated returns. But it will not apply in this case.

The Department of Transportation has made a public statement in which they said unequivocally that, "Can Norfolk Southern after investing $1.2 billion, use the $3 billion in built in income deductions to shelter income from other Norfolk Southern holdings?" The Department of Transportation answered that wrongly or falsely, take your choice. "The built in deduction limitations prevent Norfolk Southern or any other buyer from acquiring, say, $3 billion in tax benefits for its own use with a $1.2 billion investment. In general, says their statement, "those provisions limit the amount that can be used to shelter income from other holdings. In other words, the buyer gets what it pays for, no more, no less."

The only trouble with that is that is not what the law is because there is an exception, and the exception is recognized by the Norfolk Southern lawyers with whom we met. And the Norfolk Southern tax lawyers have told us they will have no problem qualifying for the exception because the value of Conrail far exceeds the 85-percent limitation that's provided in this particular statute with respect to the $3 billion basis.

Thus, the Norfolk Southern lawyers agree with my staff that they will be able to file a consolidated return and apply Conrail tax writeoffs to offset Southern's own income. That is contrary to what the Department of Transportation has advised the public.

My view is if the transaction goes through Norfolk Southern will have made one of the greatest purchases that has ever been known in this country. But it is a raw deal for the taxpayers and for the Northeast-Midwest region of the country.

I hope that in today's hearing we will obtain answers to the obvious questions raised by a proposed transaction that has all the earmarks of a monumental giveaway; on an antitrust basis, on a tax basis, and for every other possible reason this deal does not make sense.

I have not, Mr. Chairman, at this point addressed myself to another issue that this committee and other committees must look at, and that is the fact that not only is special tax treatment accorded Norfolk Southern, the purchaser, but the memorandum of intent contains a list of tax representations and warranties. And never before have I seen so many guarantees provided by the U.S. Government which refer to these promises and authorize Norfolk Southern to sue the United States if they are breached.

In addition, normal court procedures for tax disputes are waived. For example, no tax must be paid before instituting a suit in either district court or the Court of Claims as is required for other taxpayers. The United States cannot as a defense to any such suit assert that Norfolk Southern knew or should have known that the promises were false. The fate of the ESOP is still uncertain, but the bill provides special treatment. The plan administrators are provided with civil immunity; thus, the participants, the workers who are involved in the ESOP are prevented from suing if their interests in the ESOP are not fully protected. Instead, they must trust the Department of Transportation to protect them. And even if the ESOP violates ERISA rules that would disqualify it, the legislation categorically says it will be deemed to be in compliance with the law anyway.

Mr. Chairman, I have never seen any situation that was so one-sided, that was so beneficial to the purchaser and so hurtful to the economy of the Nation, to the regions affected, to the taxpayers of the country, to the shippers in the area as this piece of legislation.

And whether or not they have extended hearings or not in the Commerce Committee, I say here and now without any reservation that I am certain that this is an issue that will be debated long and zealously on the floor of the U.S. Senate if it comes to that body. Thank you, Mr. Chairman.

The CHAIRMAN. The distinguished Senator from Kentucky, do you have a statement?

Senator MCCONNELL. Mr. Chairman, I am going to be putting into the record subsequently an opening statement, but I do want to commend the chairman for holding these hearings and indicate that the proposed sale could have a major impact on my home State of Kentucky, and as a result of that I'm quite interested in hearing the testimony of the witnesses, and I will yield back the balance of my time.

The CHAIRMAN. Thank you. The distinguished ranking member of the committee, Senator Biden.

Senator BIDEN. Thank you, Mr. Chairman. Senator Metzenbaum was kind enough to say—we switched seats so I could sit next to you. I told him I did not care as long as he had the right name tag up in front of him.

I do not have any opening statement, and obviously no one is interested in any humor, so I am going to stop right now. [Laughter.]

That was funny, I thought; that was kind of interesting, but you did not like it. Anyway, I do not have anything to say, Mr. Chairman, until the hearing gets going.

The **Chairman**. The distinguished Senator from Illinois, Mr. Simon.

OPENING STATEMENT OF SENATOR PAUL SIMON

Senator **Simon**. I thank you, Mr. Chairman. I am looking at my State of Illinois and the impact of this sale there. I have made no commitments to either side. I note in the letter of transmission with the bill the Secretary of Transportation makes three points that should be weighed.

I would make three points, phrase them somewhat differently, and I differ somewhat on what those points should be. It seems to me as we weigh this, No. 1, we must be sure that we maintain an adequate railroad service in this country.

No. 2, I am concerned about the antitrust provisions. Obviously, this is the jurisdiction of this committee. I think it is important that we maintain competition for shippers.

And the third fundamental question ultimately is a judgment question, and that is—could a public sale produce at least $1.2 billion or more if a public sale were provided.

And those, I would say, are the three basic questions that must be answered for me as we hold hearings. I thank you, Mr. Chairman.

The **Chairman**. Thank you. I believe we have given an opportunity to all the members to make an opening statement here, and we will now proceed to hear from the witnesses. Senator Heinz was to be here to testify. He is not here. We will arrange to take him later.

Our first witness from the Department of Justice is the Honorable J. Paul McGrath, Assistant Attorney General in the Antitrust Division. Mr. McGrath, we would be pleased to hear from you.

We are going to allow each witness 5 minutes. The red light will come on after the 5 minutes. A warning light will come on after 4 minutes indicating there is 1 more minute.

Senator **Biden**. And then the seat disintegrates.

The **Chairman**. I will just keep time until the timekeeper gets here. You may proceed.

STATEMENT OF HON. J. PAUL McGRATH, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. **McGrath**. Thank you very much, Mr. Chairman. It is a pleasure to be here this morning to discuss the Department of Justice's antitrust analysis of the proposed sale of Conrail to Norfolk Southern. As the committee is aware, at the request of Secretary Dole, the Antitrust Division did review the competitive issues arising from the proposed transaction.

Our conclusion is that the sale of Conrail to Norfolk Southern with the divestitures that have been agreed to by Norfolk Southern and by the Department of Transportation would pose no competitive problem.

I do note, however, that the Department of Justice retains the right to approve or disapprove the actual terms of any divestiture arrangement worked out. I understand from the chairman that the written testimony we have submitted will be a part of the record. I assume that the antitrust report that I gave to Secretary Dole will also be a part of the record. It has already been referred to this morning.

Thus, I would like to just summarize what seemed to me to be the key points of our analysis. First, late last summer when it became clear that Norfolk Southern was a finalist in the bidding for Conrail, Secretary Dole asked me to have the Antitrust Division review competitive issues because it was clear that there would be significant competitive issues involved in such a sale, in particular, because a sale of Conrail to Norfolk Southern would reduce from three to two the number of significant railroads serving large areas of the northeast.

Our review was to be and was totally independent of other parts of the administration. In particular, I received no views on how we should come out from either Secretary Dole or Deputy Secretary Burnley, who were my contacts. And we did not submit a draft of our final report to the Department of Transportation before we submitted the final report to them.

Over the 4 months following Secretary Dole's request we conducted a normal antitrust review of the proposed sale. We used lawyers in the Transportation Section of the Antitrust Division and economists in our Economic Policy Office who have extensive experience in rail mergers. We applied the same kinds of legal and economic principles that we apply to mergers generally and to railroad mergers in particular.

We used our normal information sources and investigative techniques, including the gathering of data from more than 200 shippers by questionnaire and by individual interviews.

We also received extensive materials and views from many others, including other railroads, associations of shippers, and public bodies. We looked at every point from which Norfolk Southern and Conrail serve the rest of the country and to which and from which others serve the areas in question here.

We reviewed from each point the commodity-by-commodity competition situation, and we also reviewed actual and potential competition from other modes of transportation, particularly truck.

The conclusion of our transportation section and of our economists was that the proposed sale without any divestitures would raise substantial competitive problems; in brief summary, more than $500 million of 1983 Norfolk Southern/Conrail revenues were in situations where possible competitive problems would arise, and that was approximately 8 percent of the combined revenues of those companies in that year.

We also concluded that the efficiencies that were claimed by Norfolk Southern for the merger were not sufficiently proved to overcome the substantial competitive problems that we found.

However, the staff also concluded that there was a relatively straightforward way to solve the competitive problem in the corridor where the competitive problem was the most substantial, a corridor bound by Buffalo and Pittsburgh on the east and Chicago and St. Louis on the west.

The divestiture would not touch on all origin and destination points with competitive problems, but it would solve or alleviate the vast bulk of the competitive problems. And, thus the staff recommended that the acquisition be permitted with the divestitures that have been spelled out in our study.

After an extensive review of this—and I would like to underline that I was involved at every stage of this personally—I concurred in that recommendation. I agreed that without the divestiture, the competitive problems were substantial enough to indicate that the merger should be blocked.

However, in my view, the proposed divestitures do sufficiently resolve the competitive problems. Divestiture would preserve the presence of three competitors in the most significant areas of overlap, and would permit carriers from outside of that area to receive so-called friendly connections into the area.

Divestiture would completely solve any competitive problems in a number of counties by providing new, competitive rail links to those counties, and that would solve approximately $385 million of the $527 million worth of problem revenues that we found. In addition, almost $94 million of the remaining problem revenues relate to shipments from outside of the Norfolk Southern/Conrail operating areas, and since the vast bulk of those shipments are through the corridor where divestiture will be required, divestiture will substantially alleviate that problem. That left about 10 counties with around $50 million of Norfolk Southern/Conrail revenues that would not be directly affected by divestiture. And there was no practical way that we could accomplish divestiture with respect to those counties.

I concluded, however, that that was not a sufficient reason to oppose the transaction for these reasons: that revenue would be less than 1 percent of total Norfolk Southern/Conrail revenues. In addition, after divestiture shippers in the counties would be closer through truck and other means to the areas of divestiture.

And, most important, there are efficiencies to be gained from this transaction. We do not believe they rise to the level of that claimed by the parties, but we do believe it is likely that the efficiencies will at least be up to the level of the substantially less than 1 percent of total revenues of the companies that create the problem here.

And, thus, I agreed with the staff's conclusion that the proposed divestitures would preserve competition and retain at least roughly the same competitive situation in the area as was present before the sale of Conrail to Norfolk Southern.

And, most important, the Department of Justice will retain a final voice of approval to the parties to divestiture and the terms of divestiture, and thus will be in a position to ensure that the companies acquiring the divested assets will be capable of providing long term, viable and competitive rail service.

Mr. Chairman, I would be happy to answer any questions that the Committee has.

If I could just add one personal note. This will be, I think, my last time before this committee after 4 years as an Assistant Attorney General. And I would like to thank the committee for all the courtesy that has been shown to me over the years.

[Statement follows:]

U.S. Department of Justice

Washington, D.C. 20530

STATEMENT

OF

J. PAUL McGRATH
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

Mr. Chairman and Members of the Committee:

I am delighted to be here this morning to discuss the Justice Department's antitrust analysis of the proposed sale of Consolidated Rail Corporation to Norfolk Southern Corporation. Placing Conrail back into private hands is an extremely important and laudable goal. I believe an appropriately structured sale, sensitive to competitive concerns, may significantly benefit shippers currently served by the two railroads.

My remarks today will briefly summarize the Department's analysis of the competitive implications of the proposed sale and the nature of the divestiture we have recommended. The substance of our study and recommendations is set forth in more detail in my letters of January 29, 1985, and March 6, 1985, to Secretary Dole, copies of which have been provided to the Committee.

On the basis of our independent investigation, the Department has concluded that the sale of Conrail to Norfolk Southern can be accomplished without significant adverse competitive effects only if appropriate divestitures are made. Without appropriate divestitures, the sale would have a significant adverse effect on competition for the transport of certain commodities to and from a number of locations in several states, with the greatest impact occurring along an east-west rail corridor running from Buffalo and Pittsburgh in the east and East St. Louis and Chicago in the west. While the merger likely would result in certain significant efficiencies, these efficiencies do not appear to be sufficiently great to warrant approval of the merger if no divestiture is made. The Department of Justice therefore would oppose the proposed sale unless the greatest amount of its competitive problems as possible is remedied through a prior or concurrent divestiture of assets that is approved by the Attorney General.

The staff of the Antitrust Division's Transportation Section and Economic Policy Office analyzed this proposed merger using the same standards and principles generally applied to rail mergers. As with any merger, the first step was to identify economically relevant markets in which both Conrail and Norfolk Southern compete. An economically relevant market for antitrust purposes was a product and location combination which could be subject to the exercise of market power. For example, as you can see in Attachment B to my January 29 letter, iron and steel coming out of Jefferson County, Ohio was identified as one of the relevant markets.

The next step was to identify those markets in which the sale would significantly reduce competition -- i.e., markets in which the sale would significantly increase rail concentration and in which competition from other existing transportation alternatives and entry by new competitors (for example, trucking companies) would be difficult or unlikely in response to the exercise of market power following the merger.

As part of our continuing review of the proposed sale, the staff has identified more than 100 markets located in 45 counties and 21 states in which it appeared that the proposed sale could have a significant anticompetitive effect. With respect to these markets, Conrail and Norfolk Southern participated in rail movements involving $527.4 million in rail revenues in 1983. In conducting its analysis, the staff relied upon, among other things, 1977 Census of Transportation data, computer tapes from Norfolk Southern and Conrail containing data on 100 percent of the shipments carried by each of them in 1983, the ICC's 1983 national sample of railroad waybills, and surveys and interviews with over 200 shippers concerning approximately 700 facilities.

We also separately considered certain commodity movements in our analysis. For example, we specifically analyzed eastern coal movements, and found that most mine owners and coal customers have access to the services of only a single rail carrier. Largely as a result of that circumstance, Conrail and Norfolk Southern rarely compete with one another for the transportation of coal from the mines of the same shippers or to the coal burning facilities of the same end users. Where they do compete in certain destination markets, we identified those points in Attachment B of my letter of January 29 to Secretary Dole. Likewise, with respect to export coal, the available evidence indicates that Norfolk Southern and Conrail are not competitors and that in virtually all instances eastern coal mines have access to only a single originating railroad -- usually CSX or Norfolk Southern. Thus, we concluded that the acquisition of Conrail by Norfolk Southern is unlikely to affect competition for the transportation of coal significantly, and we did not include domestic or export coal shipments in our list of problem markets.

With respect to the markets in which we found that the merger could have a significant anticompetitive effect, the staff considered whether such effects might be offset by efficiencies resulting from the merger. Some of the efficiency claims made by Norfolk Southern may either have been overstated or could have been achieved without the merger. However, the staff believed, based in part on information supplied by Norfolk Southern and interviews with affected shippers, that substantial benefits would likely result from increased single-line service, an option that is in many cases both less costly to railroads and more desirable to shippers. The staff concluded that while these benefits would not be sufficiently great to outweigh the serious anticompetitive effect the sale would have absent divestiture -- particularly in the east-west corridor -- they were likely to offset the less significant adverse competitive effects that would remain possible after divestiture.

Finally, the staff considered what would be required to resolve the anticompetitive problems raised by the merger. It concluded that appropriate divestiture of Conrail and/or Norfolk Southern rail assets along the designated east-west corridor should be made to one or more independent acquirers, other than CSX or any entity owned or controlled by CSX, that would provide long-term, viable, competitive rail service similar to that now provided by Conrail and Norfolk Southern to locations along that corridor. Such a divestiture by and large would preserve competition that otherwise would be eliminated by the proposed sale. While there may be some possible anticompetitive consequences in some isolated markets after the sale and divestiture, these anticompetitive consequences are likely to be insignificant relative to the merger's expected efficiencies and the overall volume of commerce involved in the merger.

To ensure competitive service, the divestiture must satisfy three conditions. First, the acquirer (or acquirers) must demonstrate to the Attorney General's satisfaction that it possesses the managerial, operational, and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor.

Second, the divestiture should provide the acquirer direct, independent connections in the Buffalo, Chicago, Toledo, and East St. Louis gateways to one or more railroads other than the merged railroad or CSX Corporation or any railroads owned or controlled by them. This condition is essential to the competitive viability of an alternative rail line because traffic to and from the markets affected by the merger moves not only on Conrail and Norfolk Southern, but also, to a significant extent, off those lines to or from connections with other railroads at those gateways.

Third, in order to provide shippers with effective competitive access to the track and facilities of the acquirer, following divestiture the merged Norfolk Southern/Conrail entity must switch cars between its tracks and the tracks and facilities of any shipper on customary terms and conditions whenever switching is practicable and necessary in each of certain designated counties in the east-west corridor.

These conditions of divestiture have been set forth in language agreed to by the Departments of Justice and Transportation which would be included in the Agreement of Sale between Norfolk Southern and the Department of Transportation.

The specific rail tracks and facilities to be divested and the consideration to be paid should be determined by agreement among the parties to the divestiture so that the market, rather than the Department of Justice, can determine the most suitable divestiture alternative. However, as I have stated, the ultimate divestiture would be subject to the Attorney General's approval. To assist the Attorney General in evaluating the divestiture, the Department of Justice will be supplied with complete information concerning all offers and inquiries received in connection with the divestiture, including those that are rejected by either the Department of Transportation or Norfolk Southern.

With respect to the divestiture, we are aware that Guilford Transportation Industries ("GTI") and the Pittsburgh & Lake Erie Railroad ("P&LE") are negotiating with Norfolk Southern, but we do not yet have any formal proposals to review. In preparation for our review, the staff has met with both GTI and P&LE, and we have notified state officials in the region of the divestiture of our intention to review with them the details of specific proposals as they become available. The staff has also met on several occasions with transportation officials from New York and Ohio to discuss particular service needs in identified markets in those states. Finally, we have begun the process of hiring experts to assist us in our analysis when specific divestiture proposals are submitted.

Mr. Chairman, that completes my prepared remarks. I would be pleased to respond to any questions you or the other Committee members may have.

Thank you.

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General
Washington, D.C. 20530

MAR 26 1985

Honorable Elizabeth H. Dole
Secretary
Department of Transportation
Washington, D.C. 20590

Dear Secretary Dole:

This letter is to update you on the Department's analysis of the competitive implications of the proposed sale of Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk Southern"). As part of our continuing review of the proposed merger, we have determined that useful information on the competitive impact of this acquisition can be gained from the use of an additional screen. In particular, the staff has identified those counties where Norfolk Southern and Conrail provide the only available rail service, but where we did not detect significant competition between them through our use of the ICC Waybill sample and the 50/10 screen.

To undertake this additional analysis, the staff used the Conrail and Norfolk Southern 1983 traffic tapes. Using this data we identified every instance in these exclusively-served counties where both railroads originated or terminated the same commodities. We then applied the same screens (with the exception of the 50/10 and the $2 million minimum revenue screens) as are described in my January 29, 1985, letter to you. Using this methodology, we found that, in addition to the counties identified in my original letter, competition is likely to be reduced for movements to and from the following counties: Sandusky, Crawford and Coshocton, Ohio; and Howard, Blackford and Wabash, Indiana. These movements, which are reflected in the attachment to this letter, involve $11.3 million of problem revenues.

With respect to these movements, it appears that our proposed divestiture will provide for service to at least some of the counties. Under one proposal currently being discussed by Norfolk Southern and another carrier, we understand that all of these counties except Sandusky (which accounts for $794,108 of problem revenues) would be served by the independent entity. Since we have now identified these markets as markets which will be adversely affected, we will seek to ensure that they are served, just as we will seek to ensure that all affected counties in the divestiture corridor will be able to obtain competitive service. If this is accomplished, the proposed divestiture will assure that most shippers who would have been adversely affected by this merger will be able to continue to receive competitive service once the divestiture is implemented.

Sincerely,

J Paul McGrath

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Enclosure

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                    COUNTIES SERVED EXCLUSIVELY BY NS AND CR

----- SPLC=3659   COUNTY=HOWARD    ST=IN    TOTAL REVENUE=3721257 -----

                         STCC5     PRODUCT

               ORIG      37149     MOTOR VEHICLE ACCESSORIE
               DEST      40211     IRON OR STEEL SCRAP,WAST
               ORIG      40211     IRON OR STEEL SCRAP,WAST
               DEST      41114     ARTICLES, USED

----- SPLC=3479   COUNTY=COSHOC    ST=OH    TOTAL REVENUE=3369068 -----

                         STCC5     PRODUCT

               ORIG      26311     FIBERBOARD, PAPERBOARD O
               DEST      40241     PAPER WASTE OR SCRAP

----- SPLC=3648   COUNTY=BLACKF    ST=IN    TOTAL REVENUE=1658107 -----

                         STCC5     PRODUCT

               DEST      26111     PULP
               DEST      26311     FIBERBOARD, PAPERBOARD O

----- SPLC=3653   COUNTY=WABASH    ST=IN    TOTAL REVENUE=1520575 -----

                         STCC5     PRODUCT

               ORIG      26311     FIBERBOARD, PAPERBOARD O
               DEST      32952     LIGHT WEIGHT AGGREGATES,
               DEST      40214     ALUMINUM OR ALLOY SCRAP,
               DEST      40241     PAPER WASTE OR SCRAP

----- SPLC=3428   COUNTY=SANDUS    ST=OH    TOTAL REVENUE=794108 -----

                         STCC5     PRODUCT

               DEST      11212     PREPARED BITUMINOUS COAL
               ORIG      32592     NONCLAY REFRACTORIES

----- SPLC=3458   COUNTY=CRAWFO    ST=OH    TOTAL REVENUE=269663 -----

                         STCC5     PRODUCT

               DEST      26596     BLACKS
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The Chairman. Thank you. Mr. Shipman, are you keeping time now?

Mr. Shipman. Yes.

The Chairman. Now we will take 10 minute rounds each. Mr. McGrath, we thank you for appearing here and receiving the benefit of your testimony. I have a few questions I would like to propound.

Did the Department of Transportation give you any instructions or guidance in conducting your review of the antitrust implications of the sale of Conrail?

Mr. McGrath. No, Mr. Chairman; they certainly gave us no instructions at any time. We did after we began our review seek technical materials from them and also their views on some of the technical issues that we dealt with, but the methodology followed and, most important, the ultimte conclusion was not even suggested by the Department of Transportation.

The Chairman. Mr. McGrath, did the analysis of the merger of Conrail and Norfolk Southern differ in any way from the analysis performed by the Antitrust Division in other recent rail mergers?

Mr. McGrath. No. The methodology followed was essentially the same. The individual procedures followed were essentially the same. Now, the exact way data is analyzed varies frequently from one rail merger to another because the competitive realities may be different. The kind of information involved may be different. And, for instance, in ICC mergers it frequently happens that the parties and the ALJ have worked out orders of proof before the materials are submitted. But subject to those details, the analysis was essentially the same as the Department has been following for a number of years, including the years prior to this administration.

The Chairman. Mr. McGrath, in your analysis, did you take into account the amount of business that competing railroads would lose to the merged Norfolk Southern Railroad? If so, how?

Mr. McGrath. Yes, we did. These kinds of shifts in revenue are so-called diversions. And we looked to see to what extent revenues would be diverted from neighboring competing carriers to the combined Conrail/Norfolk Southern as a result of the acquisition. We did not come to a conclusion that that was competitively significant, but we did review it.

It was very difficult to come to exact numbers because estimates that were made varied a good deal. But what we concluded was, first, that as to the smaller neighboring carriers the diversions would be substantial unless the kinds of divestitures that we proposed were carried out. With those divestitures, however, and the possibility of friendly connections into the competitive area, we concluded that there would be no substantial diversions from the smaller neighboring carriers.

We also looked at the situation with respect to CSX and concluded that resulting diversions there would be only a very small fraction of the approximately $9 billion of revenues of CSX.

So we concluded that even if diversions are a competitive issue of concern on the facts of this matter there was not a factual basis to be concerned about them after the proposed divestitures that we have placed as a condition on our approval.

The CHAIRMAN. Mr. McGrath, how did you measure the benefits to competition produced by the Norfolk Southern and Conrail merger?

Mr. MCGRATH. Mr. Chairman, we really could not measure those benefits. The parties to the transaction have indicated a number of respects in which there may be savings that may occur from the transaction, the reduction of redundant facilities, the savings that can be incurred from longer end-to-end runs, particularly from the South up into the North.

We also knew from our extensive interviews of shippers that many shippers have concluded that with the longer end-to-end runs they will be able to compete in the Northeast for the first time.

We, however, had no way of measuring those efficiencies. We have become somewhat skeptical of efficiency claims, particularly in parallel rail mergers. The Penn Central merger itself taught us some skepticism in that respect. However, we concluded that because of the substantial amount of end-to-end efficiencies involved here and the enormous amount of redundant facilities, it was at least reasonable to conclude that there would be some savings. The fact that additional shippers would now be able to compete with others in the northeast obviously is a competitive plus. And since we found less than 1 percent of the revenues of the combined system to be in the competitive problem area, we concluded that it was reasonable to conclude that the kinds of benefits to be gained would at least be in that kind of neighborhood, a rather de minimis neighborhood, I should add.

The CHAIRMAN. Mr. McGrath, have you identified the tracks and facilities that must be divested by Norfolk Southern to solve the antitrust problems caused by the merger? If not, why not? If so, how?

Mr. MCGRATH. We did not identify those facilities for this reason: we felt that the best way to get an initial definition of those facilities was to let the market take care of the problem; that is, to have willing purchasers come in, work out the details of the transaction that they felt was necessary, and then we would look at the operating and the financial aspects of that transaction with the help of experts that we are retaining, with the help of financial experts, with the help of state departments of transportation to determine whether, in fact, the resulting divestiture would provide for the same level of competitive service that has heretofore been provided by the competing railroads, and also to determine whether the entities that would provide that service will be able to provide it on a long term, effective, and competitive basis.

Unless we can answer those questions "yes," we will not approve the divestiture plan.

The CHAIRMAN. Mr. McGrath, when you interviewed the 200 shippers you mentioned, what sort of things did you ask them?

Mr. MCGRATH. Well, one of the principal kinds of things we were concerned about is what alternative methods of transportation were available in given areas. The most difficult problem in evaluating railroad mergers is that it is difficult to obtain sufficient data on what we call intermodal competition, competition from trucks and competition from water facilities.

What we were looking for in particular from these shippers was what alternate means of transportation did they have available.

So that, for instance, if the merger of Conrail and Norfolk Southern would increase their share of rail transportation from a given spot dramatically, that might seem to raise a competitive problem. But if rail transportation was only handling 5 percent of the transportation of the commodity from that area, obviously that would counterbalance the competitive concern.

In addition, in many cases there were particular other problems that we looked at. If a railroad had a given kind of special arrangement with a shipper that had particular shipping problems, perhaps a large automobile manufacturer, we needed to know whether there were or were not other competitive concerns. And those might range from whether there were special shipping arrangements involved, what the competitive realities were.

So it was quite a range of issues depending upon the particular shipper involved.

The CHAIRMAN. Mr. McGrath, am I correct that your analysis shows that this merger will not have a very serious effect on coal shippers?

Mr. McGRATH. It is our conclusion that it would not have an adverse impact either on domestic coal shipments or on export coal shipments.

The CHAIRMAN. Mr. McGrath, you have told the Department of Transportation that the Attorney General must approve the purchases of the rail lines to be divested by Norfolk Southern.

Could you explain in some detail how the Justice Department will make judgments about the viability and capability of the purchasing railroad.

Mr. McGRATH. Yes. We have indicated to the Department of Transportation that we will need, among other things, information on what carriers or what other firms have expressed an interest in acquiring the divested assets. And then as to the ones selected, we would need to have total access to adequate financial data, adequate operating plan data, and so on, to enable us to determine independently the financial integrity and viability of that entity, both as it existed before divestiture and also as it might exist afterwards, including any additional financing that was involved in the transaction.

And we would plan to use both the part of the Antitrust Division that typically does this kind of financial review and also possibly an independent investment banker to look at these questions.

The CHAIRMAN. The last question I have, Mr. McGrath, your divestiture plan identifies certain gateways at which the purchaser of the divested lines must have access to other railroads. How were those particular gateways chosen?

Mr. McGRATH. Those particular gateways were chosen this way. We looked at, of course, a number of origin and destination points in our study, and we determined from that where the problems arose. That permitted us to look at the rail maps overall to see what gateways would have to be opened so that carriers from outside of the area could get into the area, could get in through friendly connections.

And the result of our study was that the principal gateways were at Buffalo and Pittsburgh and Toledo and Chicago and East St. Louis. And we feel that the correct opening of those gateways and the appropriate divestiture of tracks or track rights within the region leading up to those gateways will open up competition appropriately.

The CHAIRMAN. Mr. Shipman, is the warning light on yet?

Mr. SHIPMAN. Yes. And your time is up plus 2.

The CHAIRMAN. I have gone 2 minutes over?

Mr. SHIPMAN. Yes.

The CHAIRMAN. All right. We will give the rest of them 12 minutes, too.

Senator METZENBAUM. Oh, no, you have to do more pennance than that.

The CHAIRMAN. The distinguished Senator from Ohio. Excuse me. The distinguished ranking member, Senator Biden.

Senator BIDEN. Thank you, Mr. Chairman. Mr. Chairman, I would like to ask unanimous consent that a series of questions submitted by Senator Leahy, who is the ranking member of the Intelligence Committee and has to be at that hearing there now, be submitted to be answered for the record.

The CHAIRMAN. Without objection, that will be done.

[Information follows:]

Questions of Senator Patrick Leahy
Concerning
The Antitrust Implications of the Sale of Conrail
March 27, 1985

I know that the amount of time and effort that has gone into the economic analysis of this proposed sale has been very great, and that much more will follow.

Most of that effort, as far as I am able to observe, has been devoted to the effects of the sale on the primary competitors, Conrail itself, the Norfolk Southern Corporation, CSX, and others.

But there are many secondary or ripple effects to be considered, and some of those have been brought to my attention by Vermonters with a direct interest in maintaining competitive rail service in our State. The proposed sale could dramatically alter the competitive dynamics of rail service in Vermont, and I have no doubt that other smaller rural carriers around the country are in the same position.

Can I count on seeing analyses in the near future that will examine in some detail the indirect competitive effects of the proposed sale?

Can I assure the railroads in Vermont that before those studies are completed that they will have an opportunity to tell their side of the story?

Senator BIDEN. There are a whole lot of questions, Mr. McGrath. Let me move to a few more mundane matters. The Federal Government has invested about $2.19 billion in much of the track which is owned by Amtrak but used by Conrail between Washington and Boston.

What would happen to this track if Amtrak is eliminated as the administration has proposed? Would it be available to Conrail while bankruptcy proceedings took place to settle the debts of Amtrak or what would be the situation with regard to Norfolk if this occurs?

Mr. MCGRATH. I do not know what would be worked out on that, Senator. I would think that the Department of Transportation would be the appropriate department to answer that question.

Senator BIDEN. Let me suggest to you that it is not accidental that a number of Senators from the area that is not so humorously referred to as the Rust Bowl are very concerned about this transaction. There is no doubt that our Nation's heavy industry, steel, autos, textiles, and machine tools, are suffering at the hands of sophisticated and unrelenting foreign competition and competitive disadvantages based on transportation and energy costs with other parts of our own country.

And one of the keys to American competitiveness is the cost of overhead and that includes the cost of transporting goods.

In your view, how will the consolidation of Norfolk Southern and Conrail enhance our position in these industries?

Mr. MCGRATH. Senator, I do not know whether it will or it will not; the judgment as to whether this is a transaction that made sense from the companies' points of view, or from the government's point of view in terms of what money it would get, was not my judgment. I have no view as to whether ultimately this merger will be to the benefit of the combined company, whether overall its costs will be lower or higher.

I have personal views but not an institutional view on that. My conclusions were basically two: one, that on the basis of all the analysis we could do, on the basis of all the facts that we could look at, it was not likely that there would be a competitive problem overall from this transaction.

We did not, however, conclude that the efficiencies—and I use that term broadly—that would flow from the transaction were a substantial percentage of the revenues of the combined companies as they would have to be, I think, to result in substantially lower costs. We did not have a sufficient basis to make that conclusion.

And, thus, I cannot tell you that the combination of these two companies will result in substantially lower costs. I do not know whether it will or not. It may; I hope it will, but I do not know whether it will.

Senator BIDEN. Are you as equally in the dark as to whether or not it will result in substantially higher costs?

Mr. MCGRATH. I have no reason to believe that it will result in substantially higher costs. The fact is that there are some savings that are rather immediately available. There are some obvious redundancies between the two systems that can be immediately eliminated.

There are substantial efficiencies that can be gained from some of the longer end-to-end runs between the facilities of the two railroads. A number of shippers hope to take advantage of that, some of them to simply reduce their costs and some to get into the Northeastern area for the first time.

We have concluded it is reasonable to believe that there is therefore immediately up front some cost saving, but we have been unwilling to and unable, I think, to come to any conclusion that those cost savings would be more than a percent or so of the combined revenues of the two companies. Perhaps they will be, Senator; I would hope they would be. I guess we would all hope they would be. But I cannot conclude factually on the basis of anything we were able to see or study that they would be and we can assure this committee that they would be.

Senator **Biden**. I appreciate that. One of the major competitors of Norfolk Southern, CSX Corp., originally notified the Department of Transportation that it intended to put in a bid for Conrail, so I'm told. However, CSX claimed that it was notified by the Department of Justice that there were insurmountable obstacles to a CSX-Conrail merger and subsequently, although the Justice Department concluded the Norfolk Southern bid would violate both the Clayton Act and Interstate Transportation Act merger standards, the deal was approved conditioned on divestiture of certain assets.

Why was this remedy not available to CSX and what different antitrust problems were involved in the CSX-Conrail merger and the Norfolk Southern?

Mr. **McGrath**. Senator Biden, the statement that CSX was told that a sale of Conrail to CSX could not be permitted is untrue. No such statement was made. We have reviewed the notes of the meeting at which it was claimed that such a statement was made, and they are inconsistent with such a statement.

I have talked to the section chief of the transportation section who supposedly made such a statement, and he assures me he did not. And so I am afraid that it was simply a mistake in a bit of recollection.

Senator **Biden**. Having said that, did anyone in the Department look at whether or not CSX, assuming CSX had pursued the merger, what obstacles would be in the way? Was anything done on that?

Mr. **McGrath**. To do that we really would have had to do the same kind of very time consuming and resource consuming analysis that we did on Norfolk Southern, and there was no reason for us to do that.

Senator **Biden**. At some point in the future the Judiciary Committee will be called upon to make some kind of recommendations concerning the sale of Conrail to Norfolk Southern or to approve the sale outright. And I can see why the efficiencies of this merger might be appealing and certainly the commitment of Norfolk Southern to remain in the railroad business gives the government the best assurance that Conrail will not return to the public sector.

But I wonder, however, if there are not other remedies which we are not considering which might more appropriately address the concerns of captive shippers who will be affected by the sale.

I would like to know, Mr. McGrath, and I would like to hear at some point later, since she is not going to be here today, but from Secretary Dole on this as well. What are your views regarding reform of the Staggers Act or passage of the captive shippers act which would provide some competitive relief, allegedly provide some competitive relief to shippers who are essentially held hostage to one mode of transportation?

Mr. McGRATH. I do not have an overall view on that at this time and the Department of Justice does not have a broad position on that. That does not mean that we have not been looking at it very closely. We have; we participated, for instance, in the export coal proceeding before the ICC, and we have participated in the boxcar proceeding, which were really the two biggest proceedings raising issues having to do with captive shippers. Those two matters, of course, are still up in the air.

The fact is that the Staggers Act language that goes to this issue is—it is in dispute now just what that language means and how the ICC's jurisdiction in this area is going to work out.

And I suspect that at the very least we need to see a little bit more how those two cases are going to shake out. And I think it would probably be premature to go further than that at this point.

Senator BIDEN. I have no further questions at this time, Mr. Chairman.

The CHAIRMAN. Thank you very much. Our second witness this morning was Senator Heinz. He was unable to be here at that time. Someone said he was in the room now. Is he or not? Is Senator Heinz here? He evidently has not come. The distinguished Senator from Maryland.

Senator MATHIAS. Thank you, Mr. Chairman.

Mr. McGrath, in a letter to Secretary Dole dated the 29th of January, you indicated that the Justice Department had not considered it necessary to make a detailed analysis of the coal market because Conrail and Norfolk Southern rarely compete with one another for the transportation of coal. I believe the words you used were "from the mines of the same shippers or to the coal burning facilities of the same end users."

In the coal industry, as is normal with industries that do not have a differentiated kind of product, the competition is very often between the different mines and their transportation provider for the final market. The end user very often does not care which mine it came from or which railroad delivered the coal.

The end user, the customer, is interested in the delivery of a certain grade of coal, at a certain cost, regardless of how the coal got there, or of the particular shaft it came out of. Now, what I am wondering is whether or not the Department did any analysis at all on the overall impact on the coal industry, particularly the east coast fields, of the reduction from three shippers to two shippers.

Mr. McGRATH. We did essentially three things: one, we applied to the coal shipments in the region the same kind of analysis that we applied to all other kinds of commodities, and on the basis of that concluded that there were only a few destination points where there was a sufficient increase in concentration to raise a problem. Those are listed on the appendix to the letter you referred to, Senator, and as to those we believe divestiture, if done appropriately, would solve the problem.

In addition, we went beyond that and interviewed all of the principal coal users, utilities and so on, in the relevant area in question to find out to what extent from their point of view there would be a problem if these two railroads were combined.

And except for a very few, cases what we learned from them indicated that they had no problem and had no reason to have a problem for a variety of reasons. In a large percentage of the cases having to do with the fact that, for instance, the utility in question actually received coal from sufficient other modes of transportation that a combination of Conrail and Norfolk Southern would not make any difference to it.

In addition, we looked at the export coal situation to determine whether it was possible that the added concentration that would result from Norfolk Southern and Conrail would create a situation where our coal shippers in effect would have some monopoly power over the world price of coal, and concluded that that was not likely because of our coal shippers' competitive position worldwide as to all kinds of coal except for low volatility metallurgical coal.

And as to that coal, Conrail has done such a small amount of business that we concluded that the combination of Conrail and Norfolk Southern could not make any competitive difference.

Those are some of the things; in addition, we have had a number of conversations with other coal interests and have looked at the individual situations that they have pointed us to, and we do not now know of any situation after all of this analysis that raises a question.

I should underline that our review has been continuing since that letter because people have come to us and raised additional things and those are all matters that we would obviously have to take into account on the question of divestiture.

Senator **MATHIAS**. What was the model that you used for your analysis? Was it a single mine shaft and a single coal user or was it some other model?

Mr. **MCGRATH**. The model that we started out with as to coal and all other commodities was not a single shipper or a single mine shaft model. It was rather a county-by-county, commodity-by-commodity model.

What we did after that, however, as to commodities where we thought there was some question as to whether that analysis was appropriate, we either looked more broadly geographically or more narrowly geographically. In the case of coal shipments our factual analysis led us to the conclusion that in most cases, the individual mines or mines right in an area tend to be served by one railroad and there is no other railroad close enough to actually get in there, so that there may be situations where even if the mines are in opposite sides of the same county in some mountainous terrain or whatever, it may be that the county is too broad an area.

So we started out with a model that covered everything, but then what we tried to do was to see whether there were any real world reasons why some different considerations should be applied to, in this case, coal.

And so we did not get, in effect, hog-tied by our model.

Senator MATHIAS. You said that you looked at the export market as well as the domestic market.

Mr. MCGRATH. Yes.

Senator MATHIAS. There are six ports on the east coast that engage in coal commerce.

Mr. MCGRATH. Yes.

Senator MATHIAS. And they are served by three railroads. I do not believe that any one of the six ports have all three railroads serving it, but some combination of the three provides services to the port system.

Did you examine, in the course of this analysis, the effects on competition of reducing the number of rail carriers from three to two, and the impact of concentration of rail transportation on the utilization of the ports?

Mr. MCGRATH. No, we did not look at that because we did not consider it relevant to our analysis. If, for example, this transaction would result in a shifting of coal shipments from one city to another because—presumably that would be done because it would result in some cost saving to the carriers—we would not have considered that a competitive matter.

Indeed, if the acquisition would give the companies the opportunity to accomplish cost savings of that sort, that would be a competitive plus.

Senator MATHIAS. Well, let me ask you this, then: if that kind of shift is likely to take place, what about the decision of the ICC to deregulate export coal because they found that the market structure was sufficiently competitive to eliminate the need for any regulation? Would you think that the ICC might have to review that decision in the light of this transaction?

Mr. MCGRATH. I do not think that that decision would have to be reviewed because of this transaction. The principal issue in the export coal case had to do with whether the impact of the world market on export coal was sufficient to deprive the carriers of market power that they could misuse.

That market power allegedly arose principally because the carriers had captive shippers. The principal answer to the argument that they had monopoly power because of that captive shipper situation was that the world coal market would impact on anything that they tried to do to obtain monopoly rents on shipments of coal. Now, if we did look at the question whether this transaction through combining Conrail and Norfolk and Southern would somehow give the combined entity more market power or market power in international markets, and concluded, for the reasons I mentioned before, it would not because of the impact of the international coal market.

However, that is somewhat a different question from the question whether more coal shipments should go through one port rather than another. We did not conclude that there was necessarily going to be a substantial diversion from one port to another. It only makes sense for there to be such a diversion if there is some economically profitable reason to the resulting firm to change its pattern of shipments.

But we did not—we would not have considered the fact that there would have been a resulting change in the pattern of shipments as competitively significant.

Senator MATHIAS. Following up on that possibility, do you envision some oversight by the Justice Department of certain operations of the combined railroad.

Mr. McGRATH. Well, we certainly immediately contemplate more than oversight. We would contemplate that the Justice Department would look at the proposed divestiture plan in terms of the particular facilities to be divested, the kind of switching arrangements that were proposed to be included, and the financial, operational, and other capabilities of the entity obtaining the facilities.

Let us assume that we did approve a divestiture plan, perhaps after some changes. We would then, obviously, still concern ourselves in the future as to competitive realities of the situation.

Typically, that would come up, however, in either——

The CHAIRMAN. Your time is up, Senator.

Mr. McGRATH [continuing]. Congressional consideration of amendments to the Staggers Act or whatever or in ICC proceedings, such as the export coal proceeding.

Senator MATHIAS. My time is up, but just to finish this off, would that also require some supervision of the service to the east coast ports to protect them against any arbitrary price increases or degradation of service?

Mr. McGRATH. That I would think should be a continuing part of the ICC's regulation under the Staggers Act.

Senator MATHIAS. Thank you, Mr. Chairman.

[Department of Justice responses to questions and additional material follow:]

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

April 24, 1985

Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter responds to your letter of April 4, 1985, requesting the Department of Justice's responses to a number of questions concerning the proposed acquisition of Conrail by Norfolk Southern. Our first responses are to the questions posed by Senator Leahy:

1. Can I count on seeing analyses in the near future that will examine in some detail the indirect competitive effects of the proposed sale?

A: In analyzing the competitive implications of a Norfolk Southern/Conrail combination, the Department considered the merger's likely impact on regional carriers that connect in some way to the Norfolk Southern/Conrail systems, including regional carriers that serve the State of Vermont. Former Assistant Attorney General McGrath's letter of January 29, 1985, to Secretary Dole discusses both the direct and indirect competitive effects of the proposed sale. As described in that letter, we determined that given the proper implementation of the divestiture we have proposed, any regional carriers whose survival might have been jeopardized by merger-related diversions will be assured new friendly connections that will enable them to continue to serve their current customers. Thus, assuming that our proposals concerning independent gateways at Buffalo for railroads serving New England are properly implemented, the merger should have little effect on Vermont shippers.

2. Can I assure the railroads in Vermont that before those studies are completed that they will have an opportunity to tell their side of the story?

A: In analyzing the proposed divestitures, the Department would be pleased to have the benefit of their views. They can make arrangements to present them to us by contacting James R. Weiss, Assistant Chief of the Transportation Section of the Antitrust Division, at (202) 724-6350.

RESPONSES TO QUESTIONS POSED BY SENATOR GRASSLEY

3. With regard to those short-lines that Norfolk Southern is being required to divest itself of, what assurances do those lines and shippers have that Norfolk Southern will accord to them reasonable rates when it is necessary to utilize Norfolk Southern trackage on long-hauls?

A: The purpose of the proposed divestiture is to ensure that shippers who now receive competitive service from both Norfolk Southern and Conrail will continue to have similar competitive service available to them following the merger. The divestiture plan thus would not rely for such service on short-lines that would have to operate largely at the sufferance of Norfolk Southern following the merger. Indeed, in order to ensure that the rail carrier(s) operating on the divested lines will be economically independent, we have specifically required that after divestiture the new entities have independent access to carriers other than Norfolk Southern/Conrail or CSX at four railroad gateways: East St. Louis, Chicago, Toledo, and Buffalo. Accordingly, we do not anticipate that assurances from Norfolk Southern concerning future rates would be necessary, for in most instances shippers will have other routing alternatives and the short-lines should have other "friendly" connections available to them.

4. What market share of freight traffic would the new Norfolk Southern-Conrail line have compared to CSX and other smaller competitors, assuming that you can define the relevant market in certain regions of the country or shipping routes?

A: As reflected in former Assistant Attorney General McGrath's January 29, 1985 letter to Secretary Dole, in most instances the Department defined the relevant markets as commodities moving into or out of particular counties. Through a series of screens, we then ascertained whether the merger was likely to result in an unacceptably high level of concentration in those markets. The locations that we identified through this methodology are listed in our letters to Secretary Dole of January 29 and March 26, 1985. For each of those markets, the Department determined the 1983 combined market share for Norfolk Southern/Conrail, which is listed on the computer printout enclosed with my letter of April 15, 1985, to Chairman Dingell, a copy of which is enclosed. The market share for CSX was not separately determined, but it can be assumed that CSX and the regional carriers accounted for the percentage that was not represented by Norfolk Southern/Conrail in the region between Buffalo, Chicago, Pittsburgh and St. Louis, the region served by both Norfolk Southern and Conrail.

Future market shares are difficult to predict, but the purpose of the divestiture we have proposed is to ensure that the overwhelming majority of shippers that would otherwise lose a competitive alternative as a result of a Norfolk Southern/Conrail combination will continue to have the option of competitive service via a new entity. If the new entity meets our criteria for a viable, independent competitor, it should be able to capture a significant share of the market. Thus, it cannot be presumed that following a merger the Norfolk Southern/Conrail share necessarily would equal their combined 1983 shares.

RESPONSES TO QUESTIONS POSED BY SENATOR METZENBAUM

1. According to Mr. McGrath's letter to Secretary Dole, the Department eliminated from consideration as "problem markets" those markets "in which over a significant portion of the route into the destination or out of the origin market in question, a single carrier other than Conrail or Norfolk Southern provides rail service."

   A. Please identify each of these markets.

   B. Explain whether these markets were eliminated based on actual evidence, from shippers or others, that a reduction in competition along a part of the route would have no anticompetitive effect on the overall price of transportation.

   C. Reconcile your decision to exclude these markets with your position, as stated in comments to the Interstate Commerce Commission in connection with the Union Pacific-Missouri Pacific merger, that a merger which creates two separate monopolies for two segments of a route creates special anticompetitive problems.

A: The basis for the Department's exclusion of commodity/location combinations for which, over a significant portion of the route into or out of the market in question, a single carrier other than Norfolk Southern or Conrail provides rail service, is the economic principle that a monopolist will use its power over price to maximize its profits. Because there is a single most profitable monopoly price that can be obtained from a movement of commodities, a carrier with monopoly power can be expected to charge the monopoly rate for the entire route. If instead there are two different monopolists on connecting "monopoly legs," they generally can be expected jointly to charge the same monopoly rate for the entire route (because it yields the maximum amount of monopoly profits) and merely bargain for a division of the profits. Although the first monopolist might receive fewer monopoly profits as the result of a merger's creation of an additional monopoly leg, the monopoly charge to shippers should not change. Moreover, if instead of creating a second monopoly leg, a rail merger simply reduces the number of competitors on another leg (e.g., from three railroads to two), then the original monopolist could likely play the other carriers off against one another, keep the rate at the same monopoly level, and extract all (or most) of the monopoly profits for itself.

The markets that were eliminated from consideration as "problem markets" through the Department's "monopoly leg" screen are as follows:

Location	O/D	Commodity	NS/CR Share
Canyon, ID	Orig	Dry Onions	52%
Canyon, ID	Orig	Frozen Vegetables	51%
Jefferson, ID	Orig	Potatoes	54%
Bonneville, ID	Orig	Potatoes	50%
Aroostook, ME	Orig	Ground Wood Paper	60%
Aroostook, ME	Dest	Light Weight Aggregates	100%
Kennebec, ME	Orig	Sanitary Tissues	63%
Ramsey, MN	Dest	Motor Vehicle Assessories	92%
Warren, NY	Orig	Iron	70%
Liberty, GA	Orig	Fiberboard, Paperboard	60%
Beaver, MT	Orig	Pyrophillite	68%
Maverick, TX	Dest	Motor Vehicle Assessories	58%
Maverick, TX	Orig	Articles, Used	93%
Boone, IL	Orig	Autos	68%
Victoria, TX	Orig	Hazardous	59%
Beaver, PA	Orig	Hazardous	81%
Beaver, PA	Orig	Plastic Materials	100%
Beaver, PA	Orig	Tin Mill Products	53%
Ogle, IL	Orig	Industrial Sand	86%
Rutland, VT	Orig	Nonmetallic Minerals	78%
Saratoga, NY	Orig	Printing Paper	86%
Fort Bend, TX	Orig	Plastic Materials	65%
Berkeley, SC	Orig	Organic Acids	100%
Berkeley, SC	Orig	Wood Particle Board	76%
W. Baton Rouge,LA	Orig	Plastic Materials	77%
Jefferson, CO	Dest	Alumin Alloy Plate	69%
Obion, TN	Orig	Rubber Pneumatic Tires	68%
Blaine, OK	Orig	Gypsum Plaster	70%
Mason, WV	Orig	Plastic Materials	78%
Bay, FL	Orig	Pulp	80%
Windsor, VT	Orig	Nonmetallic Minerals	72%
Bedford, VA	Orig	Fiberboard	79%
Gibson, TN	Orig	Motor Vehicle Accessories	74%
Otsego, MI	Orig	Wood Particle Board	61%
Amherst, VA	Orig	Fiberboard	67%

These markets represented $104.8 million in total annual revenues. Many of these markets (accounting for $60 million in revenues) are located outside the Norfolk Southern/Conrail service area. As such, the competitive problems created by Norfolk Southern's acquisition of Conrail most likely would involve movements that originate or terminate in the proposed divestiture corridor. Thus, if the traffic moves--or could move--into or out of the region via either Buffalo, Chicago, or St. Louis, the proposed divestiture should ensure that the merger will have little effect on those markets located outside the Norfolk Southern/Conrail service area. Thus, as to those markets, the question whether the merger would have an adverse effect in markets where another railroad already has a "monopoly leg" is irrelevant.

In addition, Norfolk Southern and/or Conrail participated in 100% of all movements for only three commodity/location combinations (involving $6.8 million in revenues). In all other instances, Norfolk Southern/Conrail's combined share was much lower, indicating that only in very rare instances would the proposed merger create a new monopoly leg. Thus, while a merger creating a monopoly leg that connects with another monopoly leg could conceivably have some adverse effect on competition in some markets, that is not the situation in the vast majority of the markets involved here. Moreover, while these markets were not eliminated based on shipper comments, many shippers indicated that where they were already captive to a single railroad, the merger would have no significant effect on them.

The Department's position on this issue has not changed from our position before the Interstate Commerce Commission in the Union Pacific-Missouri Pacific merger proceeding. In that proceeding, our economist's analysis also excluded markets on the basis of a monopoly leg screen. After the economist's testimony, however, some shipper witnesses presented testimony that they would suffer adverse effects even though the traffic was originated or terminated by a single railroad other than one of the railroads involved in the merger. In light of that unrefuted shipper testimony, the Department concluded that it could not properly eliminate those markets from consideration. In contrast, we are not aware of any such evidence here, nor would we anticipate that such evidence might exist except in the rare instances where the merger will create a new monopoly leg. Thus, the Department's methodology did not change in our Norfolk Southern/Conrail merger review.

2. According to Mr. McGrath's letter to Secretary Dole, the Department eliminated from consideration as "problem markets" those markets "in which total revenues affected were small."

   A. What was your definition of "small?"

   B. Identify all markets involving Ohio origin or destination points which were eliminated by this criterion, where total rail revenues exceed $100,000 annually.

A: The Department's definition of a "small" problem county was one in which Norfolk Southern and Conrail were involved in movements for which rail revenues for the entire year of 1983 were less than $2 million; i.e., less than one trainload per week for the movement of most commodities. The "small" problem markets (i.e., STCC/SPLC pairs) that were not investigated and thus not listed as "problem" markets in our January 29 letter were commodity/location pairs of under $250,000 in counties where total revenues exceeded $5 million, and commodity/location pairs of under $1 million in counties where total revenues were less than $5 million.

The Ohio counties that were not included on our list of problem counties as a result of these screens are: Erie; Hamilton (which comprised two different SPLCs); Butler; Allen; Franklin; Marion, Trumbull; Summit; Fulton; Ashtabula; Lake; Hancock; Coshocton; and Mahoning. The total revenues involved in these 14 counties were less than $18 million.

3. According to Mr. McGrath's letter to Secretary Dole, the Department eliminated from consideration as "problem markets" any market where Norfolk Southern and Conrail did not together account for at least 50 percent of all rail movements in the market. Identify all markets where Conrail and Norfolk Southern each account for at least 10 percent of the market and where non-rail competition does not appear to be significant.

A: The Department has not identified markets in which Conrail and Norfolk Southern traffic participation did not satisfy our 50/10 criteria. In undertaking our analysis, we had a number of alternatives as to where to begin. We could have begun by trying to identify every commodity/location pair where intermodal competition would not be an effective check on the market power of merging railroads. To have done that, however, would have required us to inquire into the circumstances involving every one of the millions of commodity/location pairs in the United States. That approach obviously was not feasible. Accordingly, we determined that the best approach would be first to ascertain the markets in which intramodal concentration would be significantly increased by the merger, and then to apply to those markets a series of screens to determine, among other things, the effectiveness of intermodal competition in those markets. In taking this approach, we applied the tests that the Department generally has applied in its competitive analyses of rail mergers, beginning with a 50/10 screen to identify the markets where Conrail and Norfolk Southern both are significant rail competitors. The 50/10 test has been developed and employed over time because the Department has concluded that using a lower threshold would identify a large number of markets where a merger was not likely to create competitive problems.

Even using the 50/10 screen, the Department faced a very substantial task in evaluating the competitive significance of non-rail carriers. We had to incorporate into our computer analysis of the 1983 ICC waybill sample both the 1977 Census of Transportation data concerning intermodal competition and the information we received from over 200 shippers about their perceived competitive alternatives. We also met with railroads, shippers, and government officials to discuss the competitive circumstances at particular locations.

It is possible that we might have failed to identify a very few "problem markets" by beginning with a relatively "high" screen. But we obtained much more accurate information about the many "problem markets" that we identified than would have been possible if we had used the "low" screen mentioned in your question, which would have caused us to waste time and resources by examining an unmanageably high number of markets that would not have been "problem markets" in any case.

Finally, the Department's extensive experience in analyzing rail mergers has shown that few shippers perceive a need for access to more than three or four railroads in order to obtain the benefit of meaningful intramodal competition. This fact strongly suggests that a merger between two railroads, each participating in only 10 percent of the rail movements in a market, would not have an adverse effect on competition.

4. In the Department's opinion, can a new railroad entrant quickly acquire coil steel cars, heavy-duty gondolas, or special cars for handling automobiles on such terms as to allow the new entrant to effectively expand service if Norfolk Southern and CSX were to raise rates for shipments involving such speciality cars?

A: The Department does not know at this time whether a new railroad entrant could quickly acquire the type of cars referenced in this question. Specialized cars often are owned by the shippers themselves, so that the railroads serving shippers that use such cars do not have many specialized cars in their own inventory. Nonetheless, if it appears that the shippers in the divestiture region do not possess an adequate number of specialized cars to serve their needs and that the railroads serving those shippers will need such cars in order to provide viable, competitive service, then the Department will determine the availability of such equipment as part of our analysis of any proposed divestiture.

5. Applying the standards normally used by the Department in evaluating divestitures designed to cure competitive problems:

A. Is the quality of rail lines to be divested a relevant factor in determining whether the operator of such lines is a viable competitor?

B. Should Norfolk Southern be required to divest a quality line at a price less than net liquidation value if such a divestiture is necessary to assure viable competition?

A: A. The quality of the rail lines to be divested will be extremely significant in the Department's analysis of any proposed divestiture. We intend that the divestiture will provide long-term, viable, competitive rail service to the vast majority of shippers who would otherwise lose a competitive rail option as a result of the proposed merger. Thus, the Department will seek to ensure that shippers in the divestiture corridor will be able to receive essentially the same quality of rail service as they received prior to the merger. Norfolk Southern is aware that this is our view and that we will not approve a divestiture if the divested lines are not in good enough condition to provide rail service that is fully competitive in price and quality with the services of the other railroads in those markets.

B. The Department's major concern regarding the divestiture is that the entity or entities purchasing the divested assets be strong, independent competitors in the affected markets. This means that the purchaser or purchasers must be financially sound and well-managed. It also means that following the divestiture, there must be sufficient current traffic to which the new entity (or entities) will have access to enable it (or them) to maintain tracks and facilities and to earn a profit for the foreseeable future so that there will be a long-term, viable, competitive force in the markets affected by the merger. The price paid for the assets of a firm is often directly related to the revenue-generating value of those assets. Accordingly, we will also consider the amount paid for the divested properties as providing some indication of the competitive significance of those properties. If, however, the price paid for the properties is less than might be expected, we might still approve the divestiture if shippers who will use the line believe that it will meet their requirements and if it otherwise meets our criteria.

6. What standards are appropriate for determining whether a company is capable of providing long-term, viable, and competitive rail service?

A: In addition to the factors discussed in response to question 5 above, some of the specific aspects of the proposed divestiture that we will be examining in detail are the following: (1) whether the buyer or buyers will have enough rolling stock of the type needed to serve the shippers on the line; (2) whether the individuals who will manage the divested system or systems have a proven ability to manage a railroad successfully; and (3) whether the acquirer or acquirers have a bona fide intention to continue to provide rail service on a long-term basis.

7. According to Mr. McGrath's letter to Secretary Dole, the Department rejected many of the claimed efficiencies which proponents have suggested would flow from Norfolk Southern's acquisition of Conrail, because such efficiencies did not meet the "clear and convincing evidence" test established by the

Department. However, the Department did identify increased single-line service as a clear and convincing efficiency. Please estimate the annual cost savings from this efficiency.

A: The Department has not developed a formula for calculating the efficiencies resulting from single-line service. Any such formula would have to account for numerous variable factors, such as the reductions in route circuity following a merger as compared to current traffic flows, the costs of interchanging cars, labor costs, fuel costs, and the costs of transportation by other modes. In general, however, single-line movements are more efficient than alternative joint-line movements for a variety of reasons. For example, single-line service reduces or eliminates the costs of interchanging cars that are often inherent in joint-line moves. Likewise, single-line service is typically faster than joint-line service, thus giving shippers improved service. In addition, the single-line service that results from a merger is often over a more direct route than was possible prior to the merger, thus eliminating the higher costs associated with more circuitous routes. Similar savings can also be achieved by attaining higher traffic density on the more direct routes that can be used as a result of a merger. Finally, in addition to providing more efficient ways of moving traffic that is already moving by rail, a rail merger (particularly if it involves end-to-end connections) may lead to new single-line services that will attract new rail traffic that would otherwise be handled by trucks or barges.

The Department has concluded that the merger of Norfolk Southern and Conrail will create many new single-line services and thus achieve the efficiencies described above. A substantial increase in single-line services is inevitable because, except for the areas in which a divestiture must occur, the two railroad systems now serve different but adjacent regions of the country. The combination of these two rail systems, therefore, would likely result in the inauguration of numerous new single-line services, particularly for traffic moving north and south between points in the South and points in the Northeast.

In sum, while the Department has never referred to the efficiencies discussed above as "clear and convincing," we have concluded--as stated in our January 29 letter to Secretary Dole--that such efficiencies "are likely to be sufficiently great to offset the less significant adverse competitive effects that would remain after the divestiture" that we have proposed.

I trust that the above answers are responsive to your questions and will be helpful to the Committee.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

Enclosures

Antitrust Division

Office of the Assistant Attorney General
Washington, D.C. 20530

January 29, 1985

Honorable Elizabeth H. Dole
Secretary
Department of Transportation
Washington, D.C. 20590

Dear Secretary Dole:

This letter sets forth the Department of Justice's analysis of the competitive implications of a proposed sale of Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk Southern"), as you requested on September 11, 1984. As explained below, on the basis of our independent investigation, we have concluded that, without appropriate divestitures, the proposed merger would violate both Clayton Act and Interstate Commerce Act merger review standards. The merger would have a significant adverse effect on competition for the transport of commodities to and from a number of locations in several states, with the greatest adverse effect occurring at locations along an east-west rail corridor running between Buffalo and Pittsburgh in the east and St. Louis and Chicago in the west. The merger would likely enable the merged entity to achieve certain efficiencies. These efficiencies do not appear, however, to be sufficiently great to offset all of the competitive effects in all of the affected markets.

The Department of Justice therefore would oppose the proposed merger unless its competitive problems are remedied through a prior or concurrent divestiture of assets 1/ that is approved by the Attorney General. Appropriate divestiture must include divestiture of Conrail and/or Norfolk Southern rail assets along the designated corridor to one or more independent acquirers, other than CSX or any entity owned or controlled by CSX, that would provide long-term, viable, and competitive rail service to locations along the corridor. Such divestiture would preserve the vast bulk of the competition that would

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1/ "Divestiture" means the conveyance or other transfer by sale, lease, or otherwise of rail tracks and facilities or the right to use rail tracks and facilities.

have been eliminated by the merger. While there may be some possible anticompetitive consequences remaining in some isolated markets after the divestiture, these anticompetitive consequences are likely to be insignificant relative to the merger's expected efficiencies. This precondition to approval of the merger has been set forth in language agreed to by the Departments of Justice and Transportation (attached to this letter as Appendix A) which is to be included in the Agreement of Sale between Norfolk Southern and the Department of Transportation.

Our analysis is explained in detail below.

I. Competitive Analysis

A. Analytical Approach

Although mergers play a beneficial role in our economy, they sometimes may harm competition by creating, enhancing, or facilitating the exercise of "market power." "Market power" is the power of a firm or firms to raise the price of a product or service in a specific market above a competitive level for a significant period of time without fear that existing competitors or new entrants will make such a price increase unprofitable by expanding their output or charging a lower price. When only a few firms in a market into which entry is difficult account for most of the sales of a product, they may either explicitly or implicitly coordinate their actions to eliminate rivalry on price and non-price variables. When firms exercise market power in this way, the result is a transfer of wealth from buyers to sellers and a misallocation of resources that harms the economy. Therefore, a merger that would eliminate a significant competitor in an already highly concentrated market into which entry is difficult may enhance the ability of the remaining firms to exercise market power. Such a merger normally would be challenged by the Department under Section 7 of the Clayton Act unless other economic factors or some appropriate divestiture indicate that the merger should be permitted. 2/

2/ See, U.S. Department of Justice, Merger Guidelines, June 14, 1984. The standards used by the Department to analyze mergers under the Clayton Act are substantially the same as those used by the Interstate Commerce Commission, which is directed by statute to approve only transactions that are "consistent with the public interest." 49 U.S.C. § 11344. In applying this standard, the Commission disapproves transactions that would "substantially reduce the transport alternatives available to shippers unless there are substantial and demonstrable benefits to the transaction that cannot be achieved in a less anticompetitive fashion." General Policy Statement for Merger on Control of at Least Two Class I Railroads, 49 C.F.R. § 11801(a).

We analyzed this proposed merger according to the same standards and principles that we apply to mergers generally. As with any merger, our first step was to identify economically relevant markets--product-location combinations which could be subject to the exercise of market power--in which both Conrail and Norfolk Southern operate. Our next step was to identify "problem" markets (i.e., product-location combinations) with respect to which the merger would result in significantly high post-merger concentration and where entry by new firms (for example, trucking companies) would be difficult or unlikely in response to the exercise of market power following the merger. Once we identified the markets in which the merger would likely have a significant anticompetitive effect, we then considered whether these anticompetitive effects might be offset by efficiencies resulting from the merger. Finally, we considered what would be required to resolve any competitive problems that might be raised by the merger--that is, to prevent a reduction in the number of competing rail alternatives in highly concentrated markets where considerable revenues are involved and where the merger would otherwise be likely significantly to diminish competition.

B. Methodology

We defined two types of economically relevant markets for the purpose of analyzing this proposed merger--(1) transportation of a commodity to a location ("destination markets") and (2) transportation of a commodity from a location ("origin markets"). 3/ In addition to railroads, non-rail

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3/ We identified commodity and location combinations using the five-digit Standard Transportation Commodity Codes ("STCCs") and four-digit Standard Point Location Codes ("SPLCs"), respectively, designated in the 1983 ICC 1% Waybill Sample. Five-digit STCCs were used because, for the most part, the products in a single five-digit group are close substitutes for one another and have similar transportation characteristics. A four-digit SPLC is in most cases a county, although, in a significant number of cases, a single county may contain two or more four-digit SPLCs.

Usually, the relevant geographic market will be as small as a county. However, even if in some cases the market may be broader, the competitive analysis would be the same because in markets located along the east-west corridor towards which our proposed remedy is directed, there are at most four competing railroads before the merger. In addition, where we knew with some certainty that the market was broader than a county, we incorporated this into our analysis. For example, we analyzed separately outbound shipments of corn, wheat, and soybeans, as well as the movement by rail of coal to utility plants. Producers of these commodities tend to be able to select among transportation alternatives that extend beyond county lines through the use of a combination of rail and nonrail movements.

transportation modes, such as truck and barge, were considered to be in the market to the extent they appeared to be close substitutes for rail transportation.

To identify those markets in which the merger might have a significant adverse effect (i.e., would result in high post-merger concentration and would significantly increase pre-merger concentration), we first identified markets (product-location combinations) where in 1983 Conrail and Norfolk Southern each participated (independently of one another) in at least 10 percent of the rail movements and where together the two railroads accounted for at least 50 percent of all rail movements in the market. 4/ Using 1977 Census of Transportation data, supplemented by surveys and interviews with over 200 shippers concerning approximately 700 facilities, we then eliminated those markets where non-rail competition appeared to be significant. Finally, we employed a number of other screens designed to eliminate from further consideration those markets in which over a significant portion of the route into the destination or out of the origin market in question, a single carrier other than Conrail or Norfolk Southern provides rail service, in which the total revenues affected were small, or in which the major shipper in the market supported the merger.

Using this screening procedure, we identified more than one hundred markets located in 39 counties in 21 states in which it appeared that a merger between Conrail and Norfolk Southern could have a significant anticompetitive effect. With respect to these markets, Conrail and Norfolk Southern participated in movements involving $516.1 million in rail revenues in 1983. Of the 39 counties, 15 had "problem" markets in which Conrail or Norfolk Southern participated in movements involving less than $5 million of revenues. If these 15 counties had been the only locations potentially affected by the merger, we would not oppose the merger, given the likely efficiencies that would

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4/ Although in some of the markets shippers can now be served only via the tracks of either Conrail or Norfolk Southern, but not both, many of these shippers nevertheless consider other carriers identified on the Waybill to be competitive alternatives because of "reasonable" reciprocal switching arrangements currently in place. One factor that probably keeps the switching rates of Norfolk Southern and Conrail low enough to allow competition in these markets is the fact that the two carriers rely on each other for switches into different markets and each might feel constrained from unilaterally exercising its full market power (by raising the switching rates at locations it alone controls) for fear that the other railroad would retaliate in other locations. Thus, even where shippers can be reached only by the tracks of Conrail or Norfolk Southern, the merger may eliminate competition that resulted from reciprocal switching.

result from the merger and given the fact that the commerce affected as to these 15 counties is so small compared to the actual overall volume of commerce involved in the merger. Even after eliminating these counties, however, a number of others remain and the potentially affected revenues in these counties are substantial enough to be of significant concern. The remaining counties include, among others, Wayne and Washtenaw counties in Michigan; Allen and Marion counties in Indiana; Erie county in New York; and Cuyahoga, Jefferson, Lucas, Stark, and Lorain counties in Ohio, as well as several counties in the southern United States that originate shipments of pulp, paper, and fiberboard products destined for locations served by Norfolk Southern and/or Conrail in the Midwest and Northeast. 5/ In two of these counties, Jefferson county in Ohio and Allen county in Indiana, our concern is particularly acute because the number of competing railroads would be reduced from two to one. In the other counties, the competitive situation would not be much better, because the number of rail alternatives would be reduced either from three to two or from four to three. We have determined that, although they are used by shippers to some limited extent, non-rail transport alternatives are inadequate substitutes for rail transport in these markets.

We also considered the argument that following the merger, the combined entity would divert so much interchange traffic from regional railroads in the northeast and midwest that some of these railroads would be unable to compete effectively in the markets they currently serve and that the resulting loss of competition would reduce consumer welfare. We find, however, that, as a general matter, it is extremely difficult to estimate the size of future diversions. 6/ It may be even more difficult to determine whether such diversions would be so substantial as to render otherwise viable regional railroads incapable of providing competition in markets where they currently operate and where their exit would reduce competition significantly. Because diversions often result from lower costs to railroads of providing single-line, rather than interline, service and because single-line service is often attractive to shippers, any potential harm in markets currently served by regional carriers

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5/ A complete listing of the product-location combinations identified through our screening methodology is attached to this letter as Appendix B. This listing is limited to counties in which in 1983 the potential problems identified involved Norfolk Southern's and Conrail's participation in rail revenues exceeding $2 million.

6/ While we have received diversion estimates from a number of sources, including the Department of Transportation, Norfolk Southern, Conrail, and some regional carriers, these estimates vary considerably and it is very difficult to draw firm conclusions from them.

must be weighed against possibly substantial benefits. Hence, even if we knew with certainty that such diversions would significantly impair the operations, or even the viability, of regional railroads, this would not demonstrate that the diversions are, on balance, harmful to the economy. To the extent that they may be harmful, however, the divestiture that we have proposed in Section II of this letter would address that problem by ensuring that there will be an opportunity for regional carriers to continue receiving interline traffic from independent carriers other than Norfolk Southern or Conrail.

C. Efficiencies

The primary benefit of mergers to the economy is their efficiency-enhancing potential, e.g., their ability to lower overall production costs to the benefit of society. Some mergers that would significantly increase concentration in a market nevertheless result in significant real efficiencies. Therefore, if the parties to a merger establish by clear and convincing evidence that a merger will achieve such efficiencies, the Department considers those efficiencies in evaluating the merger.

As stated in the Department's Merger Guidelines, 7/ cognizable efficiencies include, but are not limited to, economies of scale, better integration of operating facilities, and similar efficiencies relating to specific operations of the merging firms. The Department also considers claimed efficiencies resulting from reductions in general administrative and overhead expenses, and other efficiencies that otherwise do not relate to specific operations of the merging firms, although, as a practical matter, those types of efficiencies are more difficult to demonstrate and to quantify. The Department does not give weight to claimed efficiencies if comparable savings reasonably could be achieved by the parties through means short of a merger likely to reduce competition.

We have reviewed efficiency claims made by Norfolk Southern. We believe that some of these claims are overstated, 8/ while others, such as abandonment of unprofitable track, would probably occur even in the absence of a merger. Nevertheless, we believe, based in part on interviews with affected shippers, that substantial benefits are likely to

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7/ U.S. Department of Justice, Merger Guidelines, June 14, 1984, at Section 3.5.

8/ For example, Norfolk Southern's estimated annual savings of $139 million due to the elimination of redundant personnel and facilities is highly speculative given the unpredictable results of union labor negotiations.

result from increased single-line service, an option that is in many cases both less costly to railroads and more desirable to shippers.

On balance, we have concluded that the possible benefits of the proposed merger are not sufficiently great to outweigh the very serious anticompetitive effect the merger would have, particularly in the designated east-west corridor. The potential efficiency gains--particularly relating to the offering of single-line service--are, however, likely to be sufficiently great to offset the less significant adverse competitive effects that would remain after the divestiture outlined in Section II of this letter is effected.

II. Proposed Remedy

As discussed above, although the proposed merger would have an anticompetitive effect in a number of markets, the markets of primary concern are located along a rail corridor bounded on the east by Buffalo and Pittsburgh and on the west by Chicago and St. Louis. Accordingly, we believe that a sale of Conrail to Norfolk Southern must be expressly conditioned on the prior or concurrent divestiture 9/ of rail assets to an independent entity or entities capable of providing long-term, viable, and competitive rail service along this corridor. For these purposes, "divestiture" means the conveyance or other transfer by sale, lease, or otherwise, of rail tracks and facilities or the right to use rail tracks and facilities.

To ensure competitive service, the divestiture must satisfy three conditions. First, the acquirer or acquirers (hereinafter "acquirer") must demonstrate to the satisfaction of the Attorney General that it possesses the managerial, operational, and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor.

Second, the divestiture should provide the acquirer direct connections in Buffalo, Chicago, Toledo, and East St. Louis to one or more railroads other than the the merged carrier or CSX Corporation or any railroad controlled by either of them. This condition is essential to the competitive viability of an alternative rail line because traffic to and from the affected markets moves not only on Conrail and Norfolk Southern lines, but also, to a significant extent, off those lines to or from

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9/ Concurrent divestiture may involve a transaction such as a contract between Norfolk Southern and a purchaser to transfer assets acquired from Conrail. Such a contract could become effective as at the closing of the sale of Conrail to Norfolk Southern.

connections with other railroads in Buffalo, Chicago, Toledo, and East St. Louis. Therefore, an independent connection to other railroads at each of these gateways would have to be available so as to remove the acquirer's need to rely upon the merged carrier or CSX to make these connections. 10/

Third, following the divestiture, in each of the designated counties in the east-west corridor, the merged Norfolk Southern/Conrail entity must switch cars between its tracks and facilities and the tracks and facilities of any shipper served by Norfolk Southern, Conrail, or Norfolk Southern/Conrail on customary terms and conditions whenever switching is practicable and necessary in order to provide a shipper with effective competitive access to the track and facilities of the acquirer.

The specific rail tracks and facilities to be divested and the consideration to be paid should be determined by agreement between the parties to the divestiture so that the market, rather than the Department of Justice, can determine the most suitable divestiture alternative. Because the divestiture would be subject to the Attorney General's approval, however, to assist him in evaluating the divestiture the Department of Justice should be supplied with complete information concerning all offers and inquiries received in connection with the divestiture, including those that are rejected by either the Department of Transportation or Norfolk Southern. 11/

This proposed divestiture addresses the vast majority of the larger "problem" markets we identified. While several markets are not affected by the proposal, these markets are either located in areas where a divestiture would be impractical or are locations where the amount of commerce shared by Conrail and Norfolk Southern was less than $5 million. When an independent rail alternative able to maintain competition within the designated corridor is found, such divestiture would resolve at least $371.4 million of potential problems out of a total of $516.1 million in the markets we have identified. In addition, this remedy would benefit some shippers, such as pulp, paper, and fiberboard producers located in 11 "problem" counties in the South, whose goods pass through or terminate in this corridor.

10/ The Toledo gateway would give shippers in Wayne and Washtenaw counties in Michigan access to a railroad other than Norfolk Southern/Conrail and CSX that provides a direct link to eastern and western destinations via Buffalo, Chicago, and East St. Louis.

11/ These terms and conditions are set forth in Appendix A and, we understand, will be included in the Agreement of Sale between the Department of Transportation and Norfolk Southern.

Finally, as discussed above, we have determined that the efficiencies that are likely to result from the proposed merger would be substantial enough to offset the potential anticompetitive effect in markets that are not directly addressed by the proposed divestiture.

III. Conclusion

I trust that this letter is responsive to your request for the Department's advice concerning the competitive impact of a sale of Conrail to Norfolk Southern. I would like to thank you and your staff for the competent and willing assistance that has been provided to us throughout our review process.

Sincerely,

J. Paul McGrath /RCA.

J. Paul McGrath
Assistant Attorney General
Antitrust Division

Attachment A

"Divestiture" means the conveyance or other transfer by sale, lease, or otherwise of rail tracks and facilities owned or operated by CR or NS or the right to use such rail tracks and facilities.

"NS" means Norfolk Southern Corporation, its subsidiaries, affiliates, successors and assigns.

"CR" means Consolidated Rail Corporation, its subsidiaries and affiliates.

"CSX" means CSX Corporation, its subsidiaries, affiliates, successors and assigns.

1. This Agreement of Sale is contingent upon prior or concurrent Divestiture sufficient to enable an acquirer or acquirers ("acquirer(s)"), not controlled as control is defined in 49 U.S.C. §10102 by NS/CR or CSX, to provide rail service along a rail corridor bounded on the West by Chicago and E.St. Louis and on the East by Buffalo and Pittsburgh, with service to, from, and between the following counties in that rail corridor: Erie, New York; Cuyahoga, Lorain, Jefferson, Lucas, and Stark, Ohio; and Allen and Marion, Indiana. Subject to the requirements of paragraph (5) with respect to Marion County, Indiana, such rail service may be limited to service along those sold or leased rail lines where prior to divestiture shippers, had service by both NS and CR. Such rail service shall include direct connections in Buffalo, E.St. Louis, Toledo and Chicago to a railroad or railroads not controlled by NS/CR or CSX as control is defined in 49 U.S.C. §10102.

2. The rail tracks, rights and facilities divested pursuant to paragraph (1) and the consideration paid therefor shall be determined by agreement between NS and the acquirer(s).

3. The Divestiture required by paragraph (1) shall be made to acquirer(s) who shall have demonstrated to the Department of Justice that they will be able to provide long-term, viable, competitive rail service along the rail corridor(s) and to, from and between the counties enumerated in paragraph (1), as indicated by their having managerial, operational, and financial capability necessary to compete effectively in the provision of such rail service. The Divestiture required by paragraph (1) may not be accomplished without the prior approval by the Attorney General of its terms and conditions and of the acquirer(s).

4. Following the execution of this Agreement of Sale, NS shall promptly solicit offers to purchase, lease, or operate upon property to be divested in accordance with paragraph (1). NS shall keep records of its efforts to accomplish the Divestiture required by paragraph (1), including the identification of any person or persons expressing an interest to any officer or official of NS, and the terms and conditions of each offer, and shall allow the Department of Justice access to such records. NS shall immediately notify the Department of Justice of the details of any offer related to the Divestiture required by paragraph (1). If NS rejects any such offer, it shall promptly notify the Department of Justice and fully describe the reasons for such rejection.

5. It is further agreed that following Divestiture NS, CR, or NS/CR shall switch cars, on terms and conditions customary at other locations within the region of the Divestiture, between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper physically served by NS, CR, or NS/CR and open to service by both as of the date hereof, at each of the counties specified in paragraph (1) whenever such switching is practicable and necessary in order to provide a shipper with effective competitive access to the tracks and facilities of the acquirer(s). Following Divestiture, in Marion County, Indiana, NS, CR or NS/CR shall establish switching charges at levels no higher than those customarily charged at other locations within the region of the Divestiture for switching cars between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper served by NS, CR or NS/CR as of the date hereof. If there is a dispute as to whether such switching is practicable and necessary, or as to such customary conditions and compensation for such switching, such dispute shall be resolved within six months by an arbitration procedure governed by the rules of the American Arbitration Association. In respect of such requirements for practicable and necessary switching of cars, the acquirer(s) and the directly affected shipper(s) shall be entitled to enforce this paragraph, in each such instance, for their sole benefit.

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MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $2 BILLION OR MORE          1

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          SPLC     COUNTY     STCC5     PRODUCT

  ORIG    4759     DALLAS     26111     PULP

  ORIG    4783     WILCOX     26311     FIBERBOARD, PAPERBOARD OR PULPBOARD

----------------------------------- ST=AR -----------------------------------

          SPLC     COUNTY     STCC5     PRODUCT

  ORIG    6118     JEFFER     26311     FIBERBOARD, PAPERBOARD OR PULPBOARD

----------------------------------- ST=FL -----------------------------------

          SPLC     COUNTY     STCC5     PRODUCT

  ORIG    4936     TAYLOR     26111     PULP

----------------------------------- ST=GA -----------------------------------

          SPLC     COUNTY     STCC5     PRODUCT

  DEST    4685     DOUGHE     26111     PULP

  ORIG    4655     GLYNN      26311     FIBERBOARD, PAPERBOARD OR PULPBOARD

  ORIG    4637     MACON      26111     PULP

----------------------------------- ST=IL -----------------------------------

          SPLC     COUNTY     STCC5     PRODUCT

  ORIG    3877     CHAMPA     20921     SOYBEAN OIL,CRUDE OR REFINED

  ORIG    3922     MACON      20419     FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
  ORIG    3922     MACON      20463     CORN SUGAR

  DEST    3876     VERMIL     28712     SUPERPHOSPHATE
  DEST    3876     VERMIL     40211     IRON OR STEEL SCRAP,WASTES OR TAILING
  ORIG    3876     VERMIL     20413     CORN MEAL OR FLOUR
  ORIG    3876     VERMIL     20419     FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
  ORIG    3876     VERMIL     20923     SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

----------------------------------- ST=IN -----------------------------------

          SPLC     COUNTY     STCC5     PRODUCT

  ORIG    3642     ADAMS      20923     SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE
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              MARKETS IN COUNTIES WITH REVENUE PRODUCERS OF [illegible] MILLION OR MORE

------------------------------------ ST=IN ------------------------------------

          SPLC     COUNTY     STCC5      PRODUCT

  DEST    3618     ALLEN      11212      PREPARED BITUMINOUS COAL
  DEST    3618     ALLEN      26311      FIBERBOARD, PAPERBOARD OR PULPBOARD
  DEST    3618     ALLEN      26471      SANITARY TISSUES OR HEALTH PRODUCTS
  DEST    3618     ALLEN      40211      IRON OR STEEL SCRAP,WASTES OR TAILING
  DEST    3618     ALLEN      41114      ARTICLES, USED
  ORIG    3618     ALLEN      37149      MOTOR VEHICLE ACCESSORIES OR PARTS,NE
  ORIG    3618     ALLEN      40211      IRON OR STEEL SCRAP,WASTES OR TAILING

  ORIG    3682     CLINTO     20923      SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

  DEST    3687     MARION     11212      PREPARED BITUMINOUS COAL
  ORIG    3687     MARION     20411      WHEAT FLOUR
  ORIG    3687     MARION     20413      CORN MEAL OR FLOUR
  ORIG    3687     MARION     20462      CORN STARCH
  ORIG    3687     MARION     20923      SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

  ORIG    3623     ST JOS     37112      MOTOR TRUCKS OR TRUCK TRACTORS,ASSEMB


------------------------------------ ST=KY ------------------------------------

          SPLC     COUNTY     STCC5      PRODUCT

  ORIG    2865     JEFFER     28212      SYNTHETIC RUBBERS
  ORIG    2865     JEFFER     36321      HOUSEHOLD REFRIGERATORS OR HOME OR FA


------------------------------------ ST=LA ------------------------------------

          SPLC     COUNTY     STCC5      PRODUCT

  ORIG    6451     ASCENS     49057      FLAMMABLE COMPRESSED GASES
  ORIG    6451     ASCENS     49065      FLAMMABLE LIQUIDS, THERMALLY UNSTABLE


------------------------------------ ST=MA ------------------------------------

          SPLC     COUNTY     STCC5      PRODUCT

  DEST    1452     HAMPDE     26311      FIBERBOARD, PAPERBOARD OR PULPBOARD


------------------------------------ ST=MI ------------------------------------

          SPLC     COUNTY     STCC5      PRODUCT

  ORIG    3167     INGHAM     37149      MOTOR VEHICLE ACCESSORIES OR PARTS,NE

  DEST    3193     KALAMA     26311      FIBERBOARD, PAPERBOARD OR PULPBOARD
  DEST    3193     KALAMA     33123      IRON OR STEEL SHEET OR STRIP

  ORIG    3184     WASHTE     37149      MOTOR VEHICLE ACCESSORIES OR PARTS,NE
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MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $1 MILLION OR MORE

---------------------------------- ST=MI ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
DEST	3181	WAYNE	20841	WINE,BRANDY OR BRANDY SPIRITS OR FRUI
DEST	3181	WAYNE	26213	PRINTING PAPER,COATED OR UNCOATED,
DEST	3181	WAYNE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
DEST	3181	WAYNE	41114	ARTICLES, USED
ORIG	3181	WAYNE	37111	MOTOR PASSENGER OR AIR CARS,ASSEMBLED
ORIG	3181	WAYNE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
ORIG	3181	WAYNE	41114	ARTICLES, USED
DEST	3183	WAYNE	41114	ARTICLES, USED
ORIG	3183	WAYNE	37111	MOTOR PASSENGER OR AIR CARS,ASSEMBLED
ORIG	3183	WAYNE	37112	MOTOR TRUCKS OR TRUCK TRACTORS,ASSEMB
ORIG	3183	WAYNE	37142	MOTOR VEHICLE ACCESSORIES
ORIG	3183	WAYNE	37147	MOTOR VEHICLE BODY PARTS
ORIG	3183	WAYNE	41114	ARTICLES, USED

---------------------------------- ST=MO ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
DEST	5675	ST LOU	33125	STRUCTURAL SHAPES OR PILING,STEEL MIL
DEST	5675	ST LOU	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
ORIG	5675	ST LOU	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE

---------------------------------- ST=KS ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	4893	ADAMS	26111	PULP

---------------------------------- ST=NC ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	4033	WASHIN	24211	LUMBER,ROUGH OR DRESSED,OF SOFTWOOD C
ORIG	4033	WASHIN	26213	PRINTING PAPER,COATED OR UNCOATED,
ORIG	4033	WASHIN	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD

---------------------------------- ST=NY ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
DEST	1654	ERIE	1195	POTATOES, OTHER THAN SWEET
DEST	1654	ERIE	20411	WHEAT FLOUR
DEST	1654	ERIE	20452	PREPARED FLOUR MIXES
DEST	1654	ERIE	20995	MIXED LOADS OF FOOD OR KINDRED PRODUC
DEST	1654	ERIE	24321	PLYWOOD OR VENEER OR BUILT-UP WOOD
DEST	1654	ERIE	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
ORIG	1654	ERIE	33123	IRON OR STEEL SHEET OR STRIP
ORIG	1654	ERIE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE

[illegible]

----------------------------------- ST=OH -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
DEST	3418	CUYAHO	11212	PREPARED BITUMINOUS COAL
DEST	3418	CUYAHO	24321	PLYWOOD OR VENEER OR BUILT-UP WOOD
DEST	3418	CUYAHO	26213	PRINTING PAPER,COATED OR UNCOATED,
DEST	3418	CUYAHO	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST	3418	CUYAHO	26471	SANITARY TISSUES OR HEALTH PRODUCTS
DEST	3418	CUYAHO	41114	ARTICLES, USED
ORIG	3418	CUYAHO	33121	STEEL INGOT OR SEMI-FINISHED SHAPES
ORIG	3418	CUYAHO	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3418	CUYAHO	40241	PAPER WASTE OR SCRAP
DEST	3419	CUYAHO	20431	COOKED CEREALS,FLAKED,GRANULATED,POPP
DEST	3419	CUYAHO	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST	3419	CUYAHO	26471	SANITARY TISSUES OR HEALTH PRODUCTS
DEST	3419	CUYAHO	41114	ARTICLES, USED
DEST	3461	HANCOC	20621	SUGAR,GRANULATED OR POWDERED,SUGAR CU
ORIG	3461	HANCOC	36311	HOUSEHOLD RANGES,OVENS OR SURFACE COO
DEST	3472	JEFFER	10111	IRON DIRECT-SHIPPING ORES, CRUDE
DEST	3472	JEFFER	11212	PREPARED BITUMINOUS COAL
DEST	3472	JEFFER	32741	LIME OR LIME PLASTER
DEST	3472	JEFFER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3472	JEFFER	33121	STEEL INGOT OR SEMI-FINISHED SHAPES
ORIG	3472	JEFFER	33123	IRON OR STEEL SHEET OR STRIP
ORIG	3472	JEFFER	33127	TIN MILL PRODUCTS
ORIG	3472	JEFFER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3422	LORAIN	29914	COKE PRODUCED FROM COAL
ORIG	3422	LORAIN	33124	IRON OR STEEL BARS,BAR SHAPES OR RODS
ORIG	3422	LORAIN	33126	IRON OR STEEL PIPE,TUBES OR FITTINGS
ORIG	3422	LORAIN	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3422	LORAIN	41114	ARTICLES, USED
DEST	3431	LUCAS	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
ORIG	3431	LUCAS	1139	GRAIN,NEC
ORIG	3431	LUCAS	20411	WHEAT FLOUR
ORIG	3431	LUCAS	20412	WHEAT BRAN, MIDDLINGS OR SHORTS
ORIG	3431	LUCAS	20419	FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
ORIG	3431	LUCAS	20431	COOKED CEREALS,FLAKED,GRANULATED,POPP
ORIG	3431	LUCAS	28128	POTASSIUM COMPOUNDS
ORIG	3431	LUCAS	29914	COKE PRODUCED FROM COAL
ORIG	3431	LUCAS	49057	FLAMMABLE COMPRESSED GASES
DEST	3445	STARK	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3449	STARK	33124	IRON OR STEEL BARS,BAR SHAPES OR RODS
ORIG	3458	WYANDO	32959	NONMETALLIC MINERALS OR EARTHS,GROUND

----------------------------------- ST=PA -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
DEST	[illegible]	BUTLER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING

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              MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $2 MILLION OR MORE

----------------------------------- ST=SC -----------------------------------

            SPLC    COUNTY    STCC5    PRODUCT

    ORIG    4478    CHARLE    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD

----------------------------------- ST=TN -----------------------------------

            SPLC    COUNTY    STCC5    PRODUCT

    ORIG    4273    MCMINN    26212    GROUND WOOD PAPER, UNCOATED

----------------------------------- ST=TX -----------------------------------

            SPLC    COUNTY    STCC5    PRODUCT

    ORIG    6847    HARRIS    28151    CYCLIC INTERMEDIATES FROM BENZENE,
    ORIG    6847    HARRIS    26212    SYNTHETIC RUBBERS
    ORIG    6847    HARRIS    49122    COMBUSTIBLE LIQUIDS, POLYMERIZABLE
    DEST    6848    HARRIS    26212    GROUND WOOD PAPER, UNCOATED
    DEST    6848    HARRIS    33126    IRON OR STEEL PIPE.TUBES OR FITTINGS
    ORIG    6848    HARRIS    26213    PRINTING PAPER.COATED OR UNCOATED.

----------------------------------- ST=VA -----------------------------------

            SPLC    COUNTY    STCC5    PRODUCT

    ORIG    2624    HOPEWE    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD
    ORIG    2624    HOPEWE    28191    AMMONIA OR AMMONIUM COMPOUNDS

----------------------------------- ST=WI -----------------------------------

            SPLC    COUNTY    STCC5    PRODUCT

    ORIG    3231    DOUGLA    20411    WHEAT FLOUR
    ORIG    3231    DOUGLA    26613    WALLBOARD
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U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

APR 8 1985

Honorable John C. Danforth
Chairman, Committee on Commerce,
  Science & Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This letter responds to your letter of March 8, 1985, concerning the Department of Justice's analysis of the competitive effects of the proposed acquisition of Conrail by Norfolk Southern. In your letter you requested that we address several contentions raised by Mr. Kelvin Dowd of the Eastern Coal Transportation Conference and Mr. Hays Watkins of CSX Corporation. You also asked us to respond to five questions from Senator Trible enclosed with your letter.

First, in his testimony to the Committee, Mr. Dowd stated that the Justice Department's analysis of the competitive impact of the Norfolk Southern purchase contains "significant deficiencies and omissions . . . which seriously impugn the credibility of its conclusions." The major "deficiencies and omissions," according to Mr. Dowd, are: (a) the scope of the Department's analysis of competitive markets is overly narrow because it is based on the so-called "50/10 test" rather than the Herfindahl-Hirschman Index (HHI) threshold used to measure market concentration in the Department's Merger Guidelines; (b) the Division's diversions analysis; (c) the Division's screening procedure; and (d) the Division's failure to consider the potential impact of the acquisition on coal transportation, particularly export coal.

With respect to Mr. Dowd's first contention, the Department of Justice has never applied an HHI threshold in analyzing rail mergers because the HHI does not adequately measure the competitive consequences of such mergers. Using the principles of market definition found in the Merger Guidelines, we often find that in railroad mergers -- including this one -- a relevant market includes firms that provide competitive alternatives through a variety of transportation modes, including truck and barge lines as well as other railroads. The HHI is an unsatisfactory tool to use under these conditions because the company-specific data needed for HHI analysis are generally unavailable for non-rail competitors, and it is often impossible to estimate accurately the ability of non-rail competitors already serving the market to expand their shares in response to possible increases in rail rates. Conversely, since the 50/10 test is applied only to rail data, that test generally will tend to overstate the actual concentration of all competitors in a relevant market. In rail mergers, therefore, the Department uses a series of screens other than the HHI, including the 50/10 test, that in combination generate the information necessary to identify areas of competitive concern.

The Department employed the 50/10 criterion in its analyses of the Chessie/Seaboard merger and the Union Pacific/Missouri Pacific/Western Pacific merger, and we used a similar test ("50/greater than zero") in our recent analysis of the proposed sale of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. The Department is also using a 50/10 screen as part of its analysis of the proposed Santa Fe/Southern Pacific merger. Mr. Dowd is therefore incorrect in suggesting that the Department has departed here from its standard approach to analyzing rail mergers.

Mr. Dowd's second contention concerns diversions and assumes that we ignored diversions in conducting our analysis. This assumption also is incorrect. In fact, we determined that given the proper implementation of the divestiture we have proposed, the regional carriers whose survival might have been jeopardized due to merger-related parallel diversions can continue to operate via friendly connections through which they can serve most of their current customers. The survival of carriers that will chiefly suffer diversions as a result of the end-to-end linking of rail tracks also will not be jeopardized, since traffic diversions from them are likely to be small relative to their total revenues. In short, no failures of regional carriers should result from either parallel or end-to-end diversions associated with the merger.

Moreover, end-to-end linkage is often beneficial to shippers because it enables them to reach, via single-line service, destinations that could previously be reached only through joint-line service. By eliminating the need for an interconnection and related costs, and by increasing efficiency, single-line service resulting from a merger often provides lower cost and greater convenience to shippers; in other words, diversions are often the result of informed consumer choices.

Mr. Dowd's third contention concerns the Department's screens. In particular, Mr. Dowd questioned the Department's alleged decision to exclude from consideration markets where "non-rail competition appeared to be significant," where "the major shipper in the markets supported the merger" or where "the total revenues affected were small." In fact, the Department did not exclude from consideration markets in which non-rail competition appeared to be significant. Rather, consistent with our prior rail merger analyses, we explicitly took into account intermodal competition in an effort to identify those markets in which competition from non-rail carriers would not merely be significant but would effectively curtail potential abuse of market power by railroads. We did this largely by examining highly disaggregated, commodity-specific rail and non-rail traffic data, and we sought to verify our results through the shipper surveys. To the extent that we found that other modes of transportation were not substitutable for rail transportation in problem markets we identified, we included those markets in Appendix B of Assistant Attorney General McGrath's letter of January 29, 1985, to Secretary Dole as "problem" markets. Most of the remaining problem markets involved movements of bulk commodities as to which non-rail transportation does not provide a reasonable alternative.

As for our reliance on the responses of major shippers, this too is in keeping with our normal investigation methodology. During the Antitrust Division's merger investigations, we interview customers who might be affected by the transaction to obtain knowledge about the markets involved and to ascertain the likely competitive effect of the acquisition in those markets. In this particular investigation, we used the information obtained from shippers primarily as a check on information already available to us from other sources. As a practical matter, because the rationale underlying the shippers' responses to our questions was not always clear, we rarely decided to include or exclude markets solely on the basis of opinions expressed to us by shippers. We were, however, more likely to rely on shipper responses when they brought to our attention relevant information of which we had been unaware. Moreover, even markets that were deleted based on shipper responses will often be benefitted by the proposed divestiture. For example, the divestiture specifically addresses the situation of Lorain County, Ohio, even though the shipments of a major rail user located there -- Ford Motor Company -- were deleted because Ford expressed support for the merger.

We also deleted from our list of problem markets certain markets where the "total revenues affected were small." We did this not only because it would have been impossible to analyze every market that might be affected in some small way by the merger, but also because we believed that certain efficiencies to be realized by this merger will benefit shippers as a whole to some degree. It is important to note that the problem markets eliminated in this manner were very small indeed; the annual rail revenues involved in each were less than $2 million and represent less than one train load per week for the movement of most commodities. Moreover, as Assistant Attorney General McGrath reported to Secretary Dole in a letter dated March 26, 1985, a copy of which is enclosed, the Division recently reexamined counties that are served exclusively by Norfolk Southern and Conrail. In our reexamination, we did not place a lower limit on the revenues generated annually (i.e., we did not use the $2 million/year screen). This reexamination revealed less than $1 million in additional "problem" revenues that will not be alleviated by the required divestiture.

A further comment on the use of "screens" in analyzing railroad mergers may be helpful. Large railroad mergers typically affect in some way hundreds, if not thousands, of markets involving a wide range of products in a variety of locations. Depending on the merger, some of these markets may be affected adversely due to a reduction in competition, while others are likely to benefit from improved service provided in the future by a more efficient post-merger competitor. Because of the intractability of any analysis that would seek to deal individually with the myriad of merger effects, the use of screens like those employed here is the typical mode of analysis in the context of rail mergers. At each stage of the screening procedure, markets are removed from consideration when it becomes clear that the merger is unlikely to create or worsen competitive problems. Thus, competitive problems can effectively be identified without unduly complicating and unreasonably delaying the analysis through straining to obtain data about markets for which the transaction does not pose competitive concerns.

In response to Mr. Dowd's last contention, we explicitly considered the impact of the acquisition on coal shippers and customers. The primary reason why we identified relatively few markets where the merger was likely to create a competitive problem in the shipment of coal is that Norfolk Southern and Conrail seldom compete to serve either the same coal origins or the same coal destinations. With respect to domestic coal movements in particular, we interviewed 72 utility customers that receive coal either directly or indirectly from Norfolk Southern or Conrail or both. Very few of these customers indicated that they would be adversely affected by the merger. The vast majority were already served by only one of the two railroads or were not concerned about the competitive effect of the merger because they were receiving their coal requirements by water or truck. However, we did identify several coal destinations as possible problem markets. These destinations, which are listed in Appendix B of our January 29, 1985, letter to Secretary Dole, generally represent coal moving to steel companies. Many of these steel companies were contacted and their comments were taken into account in our analysis.

As for export coal, the evidence suggests that to the extent that eastern railroads possess significant pricing power in the world market for coal (and it is questionable whether or not they do), Conrail is not a major carrier of that coal and does not provide a significant competitive check on whatever ability Norfolk Southern and CSX might already have to raise export coal rates to the disadvantage of export coal shippers. This conclusion is consistent with the findings of a 1981 National Economic Research Associates study commissioned by the Coal Exporters Association. That study determined that more than 90 percent of all export coal was at that time being carried by CSX and/or Norfolk Southern, that the projected capacity of Conrail's Philadelphia port was very small relative to the facilities of CSX and Norfolk Southern, and that coal to which Conrail's lines have access is not typically of a type demanded by foreign customers. Verified Statement of National Economic Research Associates, Inc., Railroad Exemption-Export Coal [Ex Parte No. 346 (Sub-No. 7)], filed before the Interstate Commerce Commission, December 18, 1981.

You have also asked us to comment on the testimony of Mr. Hays T. Watkins, Chairman and Chief Executive Officer of CSX Corporation, concerning a meeting that CSX representatives had with Antitrust Division personnel regarding the sale of Conrail. Specifically, Mr. Watkins testified that the Justice Department told CSX during 1984 that any bid made by CSX or Norfolk Southern for Conrail would be opposed on antitrust grounds. I understand, however, that Mr. Watkins never met with the Department on this matter and perhaps for that reason, his statement -- which apparently was based upon representations made to him by others -- is inaccurate in certain important respects.

The facts as we know them are that on April 27, 1984, Mr. Elliott M. Seiden, Chief of the Antitrust Division's Transportation Section, and members of his staff met with Messrs. John Snow and Mark Aaron of CSX in Mr. Seiden's office, at the request of Mr. Snow. At the meeting, Mr. Snow told Mr. Seiden that CSX was concerned that Norfolk Southern was seriously considering making a bid for the purchase of Conrail. Mr. Snow indicated that CSX had already analyzed whether a purchase of Conrail by either Norfolk Southern or CSX could satisfy our antitrust standards. Mr. Snow further stated that CSX had concluded that neither carrier could meet the standards that the Department of Justice had established in previous merger proceedings at the ICC. In light of this CSX analysis, Mr. Snow asked Mr. Seiden to respond to two questions: (1) Would the Department of Justice participate in the Department of Transportation's consideration of the various bids for Conrail that would be made later in the year; and (2) Would the Department of Justice support a request that CSX had contemplated making to the Department of Transportation for the convening by the Secretary of Transportation of a section 401 conference (under Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976, 49 U.S.C. §333(d)), which would have as its objective carving up Conrail into two systems, one to be controlled by Norfolk Southern and the other by CSX. Mr. Snow indicated that this could be accomplished in such a way as to enhance competition in the East by creating two-carrier service to New York and New Jersey (where one-carrier service now exists). In Mr. Snow's view, this would have compensated for the reduction in the number of competing railroads in the Midwest from three to two.

After hearing Mr. Snow's presentation, Mr. Seiden responded that the Department of Justice had not yet begun to analyze any possible rail consolidations involving Conrail since the bidding process had not been completed. Mr. Seiden emphasized that the Department's staff had done little more than look at some route maps, and therefore was in no position to assess the competitive consequences of any particular consolidation. As for the Department's participation in the DOT selection process, Mr. Seiden indicated that the Department was confident it would have a direct and substantive role in that process. He indicated, specifically, that Assistant Attorney General McGrath and Deputy Secretary of Transportation Burnley had already agreed that the Department would play a major substantive role in analyzing the competitive consequences of particular consolidations as they came to light and that the working relationship between the two Departments was excellent. Mr. Seiden concluded that Mr. Snow should be reassured that the Department of Justice's competitive analyses would indeed be brought to bear, if that appeared necessary or desirable. Finally, Mr. Seiden indicated that the possibility of convening a Section 401 conference was an idea that had not previously been broached and that he could not provide an immediate reaction. He indicated, however, that if the matter were to be given further attention, it would be considered on the merits.

In sum, at no time during this conversation or any other conversation between Department representatives and CSX did anyone from the Department express an opinion on the competitive consequences of any merger involving Conrail, much less focus on a possible CSX-Conrail or Norfolk Southern-Conrail consolidation.

As to the questions raised by Senator Trible concerning the Richmond, Fredericksburg and Potomac Railroad Company (RF&P), the Department recently has responded to most of them in a letter to Mr. John J. Newbauer, Jr., President of RF&P, a copy of which is also enclosed. In that letter, I pointed out that while the Department did not examine specifically the question whether RF&P could continue to compete on the Potomac Yard-Richmond route, we did examine the possible effect of diversions on CSX Corporation, and concluded that the diversions would not be so large as to jeopardize the railroad. We have assumed that such an analysis is sufficient with respect to RF&P since, while that railroad is only 34 percent owned by CSX subsidiaries, CSX controls 63 percent of its voting stock and provides the bulk of the railroad's traffic. As to protections that RF&P desires to have to ensure the continued flow of traffic over its lines, I can only reiterate the Department's position concerning such "DT&I conditions." Such conditions are, in effect, market allocations and pricing agreements that undermine the ability of merging carriers to realize the efficiencies that could otherwise be realized through their merger. Thus we would not suggest amendments to the Conrail legislation that would ensure that RF&P could maintain its current market position.

I trust this information fully responds to your letter and will be helpful to the Committee.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

Enclosures

[illegible]

Antitrust Division

Office of the Assistant Attorney General

Washington, D.C. 20530

APR 3 1985

Mr. John J. Newbauer, Jr.
President
Richmond, Fredericksburg
& Potomac Railroad Co.
P.O. Box 11281
Richmond, VA 23230

Dear Mr. Newbauer:

This letter responds to your March 1, 1985 letter concerning the acquisition of Conrail by the Norfolk Southern Railroad. In your letter you expressed concern about diversions resulting from this merger and their effect on your railroad. You also recommended the imposition of traffic protective conditions to remedy this effect.

The Department of Justice did consider the impact of diversions in its analysis. As we state in our letter to Secretary Dole, however, we do not ordinarily view diversions to be anticompetitive. Rather, we ordinarily view diversions as symptoms of more efficient routing created by a merger. Accordingly, diversions are not of concern to us except in those rare instances where they may be so great as to threaten the viability of an otherwise healthy regional competitor. Here we do not believe viability is at issue. Given the divestiture we have proposed in our letter to Secretary Dole, we do not believe that any regional carrier will fail as a result of diversions alone. Moreover, because of RF&P's close commercial relationship to CSX, we do not believe your railroad will fail as a result of Norfolk Southern's acquisition of Conrail.

You also requested the imposition of traffic protective conditions on behalf of RF&P. Such conditions are commonly referred to as DT&I conditions from the 1950 Detroit, Toledo and Ironton Railroad consolidation proceeding, 275 I.C.C. 455 (1950). The Interstate Commerce Commission ("ICC") routinely imposed this package of conditions upon rail mergers for many years. More recently, however, with the Department's encouragement and approval the ICC has adopted a very different attitude toward such conditions, recognizing that they create "anti-competitive consequences which far outweigh any procompetitive effects." St. Louis Southwestern Railway Company, 363 I.C.C. 323 (1980). Thus, the Commission has refused to impose new DT&I conditions and is now trying to eliminate such conditions that were imposed on previously approved mergers. Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings, Ex Parte No. 282 (Sub. 5), 366 I.C.C. 112 (1982). The Department of Justice supports the ICC's policy, and we think it would be an anticompetitive step backwards to impose them in this merger. Therefore, we did not recommend them as part of the divestiture plan.

I hope this letter has been responsive to your questions.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

U.S. Department of Justice

Antitrust Division

Office of the Assistant Attorney General *Washington, D.C. 20530*

April 24, 1985

Honorable Arlen Specter
United States Senate
Washington, D.C. 20510

Dear Senator Specter:

This letter responds to your letter of April 8, 1985, in which you sought additional information about the Department of Justice's analysis of the competitive implications of Norfolk Southern's proposed acquisition of Conrail. In particular, you have asked whether the combined analyses of the Departments of Transportation and Justice are equivalent to an investigation conducted by the ICC before it approves a railroad merger, and whether the Department of Justice's analysis included an examination of the information that would ordinarily be provided to the Interstate Commerce Commission ("ICC") in support of an application for approval of a railroad merger under 49 U.S.C. § 11343.

With respect to the first part of your question, the Department of Justice's mandate in this matter has been limited to undertaking a competitive analysis of the proposed merger, just as we analyze railroad mergers pending before the ICC. To the extent that the Department of Transportation has examined other aspects of the merger, we defer to that Department to explain the extent and mode of its analysis. Accordingly, we are not in a position to state whether the combined efforts of the Departments of Justice and Transportation in this matter are in all respects equivalent to a railroad merger proceeding before the ICC.

With respect to the second part of your question, the Department of Justice did examine information of the types that would be provided to the ICC in a rail merger proceeding, to the extent that it bore upon our competitive analysis. This is shown by our September 24, 1984 requests for information from Norfolk Southern and Conrail, copies of which are enclosed. As those requests show, we received many of the types of supporting information, operational data and financial information that the ICC seeks in merger cases. See 49 C.F.R. §§ 1180.6-1180.8. To the extent that our approach differed from that ordinarily followed by the ICC, it was because the Department's mandate was to undertake only a competitive analysis of the proposed merger. In contrast, the ICC generally conducts a broader study that includes a consideration of a merger's labor, environmental, and other impacts.

Our approach may also differ to some degree from that employed by the ICC because we were able to draw on our experience with non-rail mergers. As a result, we believe that our approach was superior in its ability to obtain more relevant information on the competitive effects of the proposed acquisition. For example, while the ICC's regulations require the creation of operating plans describing the merged companies' possible future operations, we sought pre-existing documents concerning the parties' perceptions of present competition between them, because such documents tend to be more credible than those created solely to support a proposed merger.

With regard to part A of the questions enclosed with your letter, the Department did obtain the information referenced in your questions A (1)-(3) and (7)-(10). With respect to the Operating Plan referenced in question A (4), we did not specifically request such a plan; however, we did obtain and analyze much of the information required in such a plan, except for information pertaining to passenger and commuter service, which, of course, is not affected by the proposed acquisition. Finally, we neither sought nor received specific information about the merger's potential labor or environmental impact, other than information that related to the companies' efficiencies projections.

With regard to part B of the questions enclosed with your letter, the answer to questions B (1)-(3) is "yes." The Department analyzed the information that we received in great detail. Our analysis was summarized in former Assistant Attorney General McGrath's January 29 and March 26, 1985 letters to Secretary Dole. Additional details recently have been provided to the Congress in my letters to Chairmen Danforth and Dingell, copies of which are also enclosed. As those letters indicate, the Department did rely to some extent on studies and representations made by Norfolk Southern, but in reaching our conclusions we relied more heavily on other sources, such as the ICC Waybill Sample, the 1977 Census of Transportation, the railroads' traffic tapes, and shippers' responses to the questionnaires we sent to them and the interviews we had with them.

Question B (4) asks whether any Operating Plans or studies prepared by Norfolk Southern or their consultants were served on state departments of transporation in the States in which Norfolk Southern or Conrail operate. We have not effected such service and do not know whether any other person has done so.

Question B (5) asks whether such plans or studies were made available to us. We discuss this matter in our responses to question A (4) above and question B (11) below.

Question B (6) asks whether such plans or studies have been made available to the Federal Trade Commission. We do not know whether that was done.

Questions B (7) and (8) ask whether the Department of Justice has published notices in the Federal Register concerning "the availability of such studies to interested parties" or "soliciting the comments and studies of interested parties" about the proposed merger. We have not published any such notices. As explained above, however, we have solicited the views of many persons about the merger, including shippers, other railroads, and state governments. Moreover, the fact that we were analyzing the competitive effects of the proposed acquisition was well known at the time.

Question B (9) asks whether any analysis was performed of "the anticipated operations of Norfolk Southern's proposal prior to reducing the number of applications from 15 to 3." We did not perform such an analysis and do not know whether any other entity did so.

Question B (10) asks whether it is "still the testimony of DOJ that further review of the Norfolk Southern/Conrail merger by the ICC would be redundant to that performed by DOT or DOJ?" With respect to the competitive analysis performed by the Department of Justice, the answer is "yes." As explained above, our competitive analysis was at least as rigorous as any that might have been done by the ICC. Moreover, in undertaking our analysis we brought to bear not only our experience with rail mergers, but also our extensive experience with other types of mergers.

Question B (11) asks how the Department can determine the ability of the divestiture plans to provide long term competition to Norfolk Southern/Conrail, since the Department currently has no detailed operating plans for the Norfolk Southern/Conrail system against which to compare the services to be rendered over the divested lines. As noted above, much of the information included in such an operating plan would not be pertinent to the competitive analysis required here, and we would tend to discount such company-generated projections in any event. We do know the detailed operating history of the Norfolk Southern and Conrail lines and the changes that Norfolk Southern proposes to make after the merger. The Department thus knows a great deal about the shippers being served, the nature and volume of their rail shipments, the routes they are using, and the rates they are paying. This information was very useful in our competitive analysis and will be very useful in our analysis of the divestiture plans.

Finally, question B (12) asks

> I understand that the Department of Justice has contacted various State DOT's to comment on the divestiture plans from Guilford and P&LE. In your judgment, can those states provide meaningful analyses of the ability of P&LE or Guilford to render service that can compete with Norfolk Southern/Conrail within one week without having access to detailed operating plans for the Norfolk Southern/Conrail system?

The answer to this question is "no." The Department does not expect that anyone would be able to complete a thorough analysis within a week. The intent of our letters to the states--a sample of which is enclosed--was to open a dialogue with them. Our purpose in contacting them one week after their receipt of the specific divestiture plans will be to obtain their preliminary thoughts on the plans and to identify the issues that they consider to be important. Our own analysis of the divestiture plans, of course, will take longer than a week, and we expect to communicate frequently with affected state departments of transportation throughout that process. In fact, the dialogue has already begun; our staff has met with representatives from Indiana, New York, and Ohio.

With respect to your request for copies of documents reviewed by the Department of Justice in connection with this matter, we are providing the Committee with copies of two boxes of documents that we have supplied to Chairman Florio, and an accompanying letter to Chairman Florio. Any request for documents from the Department of Transportation should be addressed to that Department.

I trust that this letter fully responds to your questions and will be of assistance to you.

Sincerely,

Charles F. Rule
Acting Assistant Attorney General
Antitrust Division

Enclosures

U.S. Department of Justice

EMS:PAM
60-192-037-11

24 SEP 1984

EXPRESS MAIL

Bruce B. Wilson, Esquire
Vice President and General Counsel
Consolidated Rail Corp.
Transportation Center
6 Penn Center Plaza
Philadelphia, PA 19104

Dear Mr. Wilson:

As you know, the Justice Department has been asked by the Department of Transportation to review the possible acquisition of Conrail by the Norfolk Southern Corporation. In order that we might assess the competitive implications of such a merger, below we set out a certain number of questions and document requests that we would appreciate your responding to as quickly as possible. Unless otherwise indicated, the information provided should be for the period 1982 to the present:

1. Provide such computerized records as will show for all traffic handled by Conrail in calendar years 1982 and 1983:

   a. the origin of the traffic
   b. its destination
   c. the shipper
   d. the consignee
   e. the originating carrier
   f. the terminating carrier
   g. any bridge carriers involved in the movement
   h. the commodity or commodities involved in the move (by 5-digit STCC if possible)
   i. the number of car loads involved in the move
   j. the tonnage involved in the move
   k. revenues
   l. length of haul

2. Identify those commodities that constituted three percent or more of Conrail's total annual shipments, and for each such commodity identify the 10 largest shippers (in terms of car loads and tons) and provide the name of the shippers' senior official in charge of traffic.

3. Provide all studies, reports, memoranda or similar documents pertaining to the possible effects on competition, both intermodal and intramodal, of the acquisition of Conrail by Norfolk Southern.

4. Provide all studies, reports, memoranda or similar documents pertaining to possible diversions of traffic from other railroads as a result of a Norfolk Southern acquisition of Conrail.

5. Provide all studies, reports, memoranda or similar documents pertaining to any existing competition between Norfolk Southern and Conrail.

6. Provide all studies, reports, memoranda or similar documents pertaining to the benefits or efficiencies that might be accomplished by the proposed transaction, e.g., operating economies, elimination of excess facilities, improvements of service or improvement of the financial viability of either Norfolk Southern or Conrail.

7. Submit a map indicating clearly, in separate colors or otherwise, the lines of Norfolk Southern and Conrail and their relations to each other, short line connections, other rail lines in the territory covered by the railroads, and the principal geographic points in the region traversed by the railroads.

8. Submit the following forms that have been filed with the Securities and Exchange Commission or the Interstate Commerce Commission within the past three calendar years:

a. all Form 10-K's
b. all Form S-14's
c. Annual Reports

9. Submit all studies, reports, memoranda or similar documents that pertain to the anticipated effects on traffic patterns, flows and market concentration created by an acquisition of Conrail by Norfolk Southern.

10. Provide all studies, reports, memoranda or similar documents that pertain to the manner in which the operations of either Norfolk Southern or Conrail might be changed following a Norfolk Southern acquisition of Conrail.

11. Provide all reports or similar mmemoranda that refer or relate in any way to discussions between Conrail and any shipper concerning the possible acquisition of Conrail by Norfolk Southern.

We are trying to complete our review of the proposed transaction in as short a time as possible so we would appreciate an expeditious reply to our information requests. If, however, any specific request is particularly burdensome or is, in your view, duplicative of other requests, please bring those items to the attention of Jim Weiss or me so that if it is appropriate to do so we might modify them. The number where I can be reached is 202-724-6478. Jim Weiss can be contacted at 202-724-6350.

Thank you for your cooperation in this matter.

Sincerely,

Paul A. Mapes
Attorney
Transportation Section
Antitrust Division

U.S. Department of Justice

EMS:JRW
60-192-037-11

24 SEP 1984

John S. Shannon, Esq.
Executive Vice President
  of Law
Norfolk Southern Corporation
P.O. Box 3609
Norfolk, Virginia 23514

Dear Mr. Shannon:

As I told you in our telephone conversation last week, the Justice Department has been asked by the Department of Transportation to review the possible acquisition of Conrail by the Norfolk Southern Corporation. In order that we might assess the competitive implications of such a merger, below we set out a certain number of questions and document requests that we would appreciate your responding to as quickly as possible. Unless otherwise indicated, the information provided should be for the period 1982 to the present:

1. Provide such computerized records as will show for all traffic handled by Norfolk Southern in calendar years 1982 and 1983:

    a. the origin of the traffic
    b. its destination
    c. the shipper
    d. the consignee
    e. the originating carrier
    f. the terminating carrier
    g. any bridge carriers involved in the movement
    h. the commodity or commodities involved in the move (by 5-digit STCC, if available)
    i. the number of car loads involved in the move
    j. the tonnage involved in the move
    k. revenues
    l. length of haul

2. Identify those commodities that constituted three percent or more of Norfolk Southern's total annual shipments, and for each such commodity identify the 10 largest shippers (in terms of carloads and tons) and provide the name of the shipper's senior official in charge of traffic.

3. Provide all studies, reports, memoranda or similar documents pertaining to the possible effects on competition, both intermodal and intramodal, of the acquisition of Conrail by Norfolk Southern.

4. Provide all studies, reports, memoranda of similar documents pertaining to possible diversions of traffic from other railroads as a result of a Norfolk Southern acquisition of Conrail.

5. Provide all studies, reports, memoranda or similar documents pertaining to any existing competition between Norfolk Southern and Conrail.

6. Provide all studies, reports, memoranda or similar documents pertaining to the benefits or efficiencies sought to be accomplished by the proposed transaction, e.g., operating economies, elimination of excess facilities, improvements of service or improvement of the financial viability of either Norfolk Southern or Conrail.

7. Submit a map indicating clearly, in separate colors or otherwise, the lines of Norfolk Southern and Conrail and their relations to each other, short line connections, other rail lines in the territory covered by the railroads, and the principal geographic points in the region traversed by the railroads.

8. Submit the following forms that have been filed with the Securities and Exchange Commission or the Interstate Commerce Commission within the past three calendar years:

a. all Form 10-K's
b. all Form S-14's
c. Annual Reports

9. Submit all studies, reports, memoranda or similar documents that pertain to the anticipated effects on traffic patterns, flows and market concentration created by the acquisition of Conrail by Norfolk Southern.

10. Provide all studies, reports, memoranda or similar documents that pertain to the manner in which the operations of either Norfolk Southern or Conrail would be changed following a Norfolk Southern acquisition of Conrail.

11. Provide all reports or similar memoranda that refer or relate in any way to discussions between Norfolk Southern and any shipper concerning the manner of handling or the rates for handling the shipper's cargo following the acquisition of Conrail by Norfolk Southern.

As I told you, we are trying to complete our review of the proposed transaction in as short a time as possible so we would appreciate an expeditious reply to our information requests. If, however, any specific request is particularly burdensome or is, in your view, duplicative of other requests, please bring those items to my attention so that if it is appropriate to do so we might modify them. The number where I can be reached is 202-724-6350. If I am unavailable, you should call Paul Mapes at 202-724-6478.

Thank you for your cooperation in this matter.

Sincerely,

James R Weiss

James R. Weiss
Assistant Chief
Transportation Section
Antitrust Division

U.S. Department of Justice

JRW:PAM:LAB

EMS:JRW:PAM
60-192-037-11

Dr. Thomas Larson
Secretary of Transportation
Pennsylvania Department of Transportation
Room 1200
Transportation and Safety Building
Harrisburg, PA 17120

Re: Divestiture of Rail Properties in Connection with the Sale of Conrail to Norfolk Southern Corporation

Dear Dr. Larson:

As you know, one of the conditions that has been imposed on Norfolk Southern's intended acquisition of Conrail is the divestiture of tracks and facilities to an independent entity or entities that will be able to provide competing rail services in various areas now served by both Norfolk Southern and Conrail. The divestiture must be reviewed by the Attorney General and will not be approved unless the Attorney General is satisfied that the acquirer(s) will be able to provide "long-term, viable, competitive rail service" in the transportation markets most affected by the merger.

In order to comply with this divestiture condition, Norfolk Southern has recently agreed to transfer certain rail properties to Guilford Transportation Industries and to the Pittsburgh and Lake Erie Railroad (P&LE). The Justice Department, accordingly, has asked Guilford and P&LE to submit copies of their agreement with Norfolk Southern and their plans for operating the new rail services. As soon as these materials are received, the Department's attorneys, economists and financial analysts will begin reviewing this information to determine if it satisfies all the requirements of the divestiture plan.

Before the Department can make a final judgment we will need to obtain very detailed information about the rail transportation markets that will be affected by the divestiture. In order to develop this information, we are asking your assistance in evaluating the probable effects in your State of the proposed divestiture to Guilford and P&LE. In particular, we would like to receive any comments or information you may have on the question of whether or not the facilities that are proposed to be divested are likely to be suitable for the provision of a long-term, viable and competitive rail transportation service alternative for those shippers in your State that can now use either Norfolk Southern or Conrail. To assist you in this regard, I intend to send you copies of the Guilford and P&LE operating plans, as soon as those materials are available to me. After you have had a week to consider how the proposed divestiture would affect your State, I would like to confer with you and hear your views. If you believe it would be helpful, I and the other Justice Department employees who are working on this project would be happpy to meet with you at your office or in those areas of Pennsylvania most affected by the divestiture.

Please call me if you have any questions or suggestions concerning this matter. My telephone number is (202) 724-6250.

Sincerely yours,

James R. Weiss
Assistant Chief
Transportation Section
Antitrust Division

cc: Eugene F. Wayne
Deputy Attorney General
Commonwealth of Pennsylvania

The CHAIRMAN. Senator Heinz was to be our second witness. He was unable to be here at that time. Senator, would you care to testify now?

STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Senator HEINZ. Mr. Chairman, I thank the committee very much. I want to extend my apologies to all Senators and Mr. McGrath for interrupting his testimony at this point. I am deeply grateful to you all and I will try to be as brief as possible.

What I have to say may fit well with the discussions that seem to have been taking place so far. I thank all of you, Mr. Chairman, for this opportunity to testify before your committee and to join my distinguished colleague from Pennsylvania, who I understand testified earlier.

The CHAIRMAN. Senator, I forgot to announce to you there is a 5-minute limit. You can put your entire statement in the record. You have 5-minutes.

Senator HEINZ. Yes, Mr. Chairman. Mr. Chairman, there should not be any doubt in anyone's mind that merging Conrail and Norfolk Southern in their present forms would be seriously anticompetitive. The Justice Department has already indicated that it will oppose such a merger unless Norfolk Southern divests itself of certain major routes in the process.

The fact that the Department of Justice has proposed and Norfolk and Southern has accepted a series of route divestitures does not fill me with confidence about the proposed merger. To the contrary, I am not at all certain that the route divestitures urged by the Department of Justice will solve the antitrust problems this merger presents. Apparently Norfolk and Southern agrees.

At the insistence of Norfolk Southern's lawyers, the Conrail sale legislation pending before the Senate contains the following provision: "This merger shall be deemed approved by the Interstate Commerce Commission." The effect of this innocent looking provision is simple. The Conrail/Norfolk merger will be granted immunity from Federal antitrust laws and from other laws, including State and municipal laws, as necessary.

I would submit, Mr. Chairman, that Norfolk and Southern would not have insisted on this sweeping immunity clause had it not believed that the proposed merger to be seriously anticompetitive. The proposal to merge Conrail with Norfolk Southern will require a great deal of scrutiny if Congress is going to completely immunize it from this Nation's antitrust laws.

While I do not fancy myself an expert in the area of rail competition or antitrust litigation, I do not believe that the scrutiny thus far has been sufficient. Because the Justice Department limited its antitrust review to only a small number of relatively high volume markets where Conrail and Norfolk Southern are in direct competition, literally thousands of potential antitrust problems may have been completely overlooked.

Mr. Chairman, I believe that a Conrail/Norfolk merger could mean reduced competition for as many as 5,559 shipping points in as many as 25 States of the Union. This reduced competition is of three varieties which, with the help of a few charts, I would like to try and make clear.

The first variety of reduced competition likely to result from the merger is fairly obvious; at shipping points where Conrail and Norfolk Southern are presently the only two carriers available, the number of railroads will decline from two to one after the merger takes place.

As my first chart shows, Pittsburgh, PA, is just such a point. Steelmakers in Pittsburgh wishing to ship their product to the General Motors plant in Indianapolis may presently choose between Conrail and Norfolk Southern to carry their goods to market. After the sale, both routes to Indianapolis from Pittsburgh will be controlled by Norfolk Southern and competition will vanish.

To its credit the antitrust remedy proposed by the Department of Justice attempts to mitigate this variety of anticompetition. The route divestitures I mentioned earlier are designed to ensure that where the number of competing railroads goes from two to one, the competitive balance will be restored by forcing Norfolk Southern to sell parallel routes to regional carriers.

It remains to be seen, however, exactly how many of the anticompetitive problems of this first variety will actually be solved by Justice's remedy.

The second variety of competition likely to be reduced by DOT's proposal is a form of indirect competition. Chart No. 2 will help me explain. Shippers in Camp Hill, PA, are presently served by only one carrier, Conrail. However, depending on what destination they choose, Camp Hill shippers may be able to take advantage of rail competition at some point further down the line.

For example, a manufacturer in Camp Hill who wants to ship pencils to Atlanta must ship his goods via Conrail at least as far as Washington, DC. At Washington, however, our pencil manufacturer may choose between CSX and Norfolk Southern to carry his goods the rest of the way to Atlanta. After the sale, Norfolk Southern could conceivably deny the pencil manufacturer the right to switch his goods onto CSX at Washington and force him instead to ship over Norfolk Southern, thus depriving him of the fruits of competition he previously enjoyed.

Although this variety of competition is slightly more difficult to explain than the first, it will be no less real to those shippers who will be made to suffer its effects. To my knowledge, the Department of Justice has not at all reviewed the likely effect of the Conrail/Norfolk merger on this form of indirect competition.

The third variety of competition likely to be reduced by a Conrail/Norfolk merger is, like the second variety, a form of indirect competition. Again, an illustration: shippers in Griffin, GA, are presently served by only one rail carrier, Norfolk Southern. However, depending upon what destination they choose, Griffin shippers may be able to take advantage of rail competition at some point further up the line.

For instance, a miller in Griffin who wants to ship lumber to Salamanca, NY, must ship his product via Norfolk-Southern at least as far as Washington, DC. In Washington, however, our miller may choose between Conrail and CSX to carry his wood the rest of the way to Salamanca.

After the sale, Norfolk Southern could deny our miller the right to switch his lumber onto CSX and force him instead to ship over Conrail, thus depriving him of the advantages which were previously his.

The CHAIRMAN. Your time is up, Senator.

Senator HEINZ. Mr. Chairman, I will abbreviate the rest and just summarize by saying I certainly hope that this committee moves to uncover the full facts in this matter before recommending the adoption of the Secretary's plan because if you do not thousands upon thousands of companies who ship by rail could fall through the cracks and suffer the fate of captive shippers everywhere: decreased flexibility and service, and increased shipping rates. The resulting costs will ultimately be passed on to consumers in the form of higher prices or onto workers in the form of unemployment.

I do not think this committee nor the Congress wants to go on record as favoring either higher prices or unemployment.

Mr. Chairman, I thank the committee for their courtesies in allow me to testify and I am available to answer any questions.

[Statement follows:]

PREPARED STATEMENT OF SENATOR JOHN HEINZ

Mr. Chairman, I would like to thank my colleagues for giving me an opportunity to provide this committee with my views on the Department of Transportation's proposal to return Conrail to the private sector.

Secretary Dole and I share the objective that Conrail should be returned to the private sector, we do not agree on how to go about achieving that goal. However I oppose the Secretary's proposal to sell Conrail to Norfolk-Southern because of its effect on competition, the availability and increased cost of service and the consequent loss of jobs that necessarily will follow. I have called instead for a contingent public offering of Conrail stock.

Mr. Chairman, I oppose the Conrail-Norfolk merger for several reasons. However, knowing of your Committee's keen interest and broad expertise in the field of antitrust law, I will confine my comments today largely to the fact that the Department of Transportation's proposal to sell Conrail to Norfolk-Southern is grossly anticompetitive.

There can be no doubt in anyone's mind, Mr. Chairman, that merging Conrail and Norfolk-Southern in their present forms would be seriously anticompetitive. The Department of Justice has already indicated that it will oppose such a merger unless Norfolk-Southern divests itself of certain major routes in the process.

The fact that the Department of Justice has proposed, and Norfolk-Southern has accepted, a series of route divestitures does not fill me with confidence about the proposed merger. To the contrary, I am not at all certain that the route divestitures urged by the Department of Justice will solve the antitrust problems this merger presents. Apparently, Norfolk-Southern agrees.

At the insistence of Norfolk-Southern's lawyers, the Conrail sale legislation pending before the Senate contains the following provision: "This merger shall be deemed approved by the (Interstate Commerce) Commission." The effect of this innocent-looking provision is simple: the Conrail-Norfolk merger will be granted immunity from federal antitrust laws and from all other laws, including state and municipal laws, as necessary. I would submit, Mr. Chairman, that Norfolk-Southern would not have insisted on this sweeping immunity clause had it not believed the proposed merger to be seriously anticompetitive.

The proposal to merge Conrail with Norfolk-Southern will require a great deal of scrutiny if the Congress is going to completely immunize it from this nation's antitrust laws. While I do not fancy myself an expert in the area of rail competition or antitrust litigation, I do not believe the scrutiny thus far has been sufficient. Because the Department of Justice limited its antitrust review to only a small number of relatively high-volume markets where Conrail and Norfolk-Southern are in direct competition, thousands of potential antitrust problems may have been completely overlooked.

Mr. Chairman, I believe that a Conrail-Norfolk merger could mean reduced competition for as many as 5,559 shipping points in as many as 25 states of the Union. This reduced competition is of three varieties which, with the help of a few charts, I will try to make clear to you.

The first variety of reduced competition likely to result from a Conrail-Norfolk merger is fairly obvious. At shipping-points where Conrail and Norfolk-Southern are presently the only two carriers available, the number of railroads will decline from two to one after the merger takes place.

As my first chart shows, Pittsburgh, PA is just such a point. Steelmakers in Pittsburgh wishing to ship their product to the General Motors plant in Indianapolis may presently choose between Conrail and Norfolk-Southern to carry their goods to market. After the sale, both routes to Indianapolis from Pittsburgh will be controlled by Norfolk-Southern, and competition will vanish.

To its credit, the antitrust remedy proposed by the Department of Justice attempts to mitigate this variety of anticompetition. The route divestitures I mentioned earlier are designed to ensure that where the number of competing railroads goes from two to one, the competitive balance will be restored by forcing Norfolk-Southern to sell parallel routes to regional carriers. It remains to be seen however, exactly how many of the anticompetitive problems of this first variety will actually be solved by DOT's remedy.

The second variety of competition likely to be reduced by DOT's proposal is a form of indirect competition. Chart #2 will help me explain.

Shippers in Camp Hill, PA, are presently served by only one carrier—Conrail. However, depending upon what destination they choose, Camp Hill shippers may be able to take advantage of rail competition at some point further down the line. For instance, a manufacturer in Camp Hill who wants to ship pencils to Atlanta must ship his goods via Conrail at least as far as Washington, DC. At Washington, however, our pencil manufacturer may choose between CSX and Norfolk-Southern to carry his goods the rest of the way to Atlanta. After the sale, Norfolk-Southern could conceivably deny our pencil manufacturer the right to switch his goods onto CSX at Washington, and force him instead to ship over Norfolk-Southern—thus depriving him of the fruits of competition he previously enjoyed.

Although this variety of competition is slightly more difficult to explain than the first, it will be no less real to those shippers who will be made to suffer its effects. To my knowledge, the Department of Justice has not at all reviewed the likely effect the Conrail-Norfolk merger will have on this form of indirect competition.

The third variety of competition likely to be reduced by a Conrail-Norfolk merger is, like the second variety, a form of indirect competition. Again, an illustration will be useful.

Shippers in Griffin, GA, are presently served by only one rail carrier—Norfolk-Southern. However, depending upon what destination they choose, Griffin shippers may be able to take advantage of rail competition at some point further up the line. For instance, a farmer in Griffin who wants to ship hogs to Salamanca, NY, must ship his animals via Norfolk-Southern at least as far as Washington, DC. In Washington, however, our hog farmer may choose between Conrail and CSX to carry his goods the rest of the way to Salamanca. After the sale, Norfolk-Southern could deny our hog farmer the right to switch his animals onto CSX, and force him instead to ship over Conrail—thus depriving him of the advantages which were previously his.

This variety of reduced competition, like the kind before it, poses a serious threat to the economic health of thousands of shippers, yet has not been reviewed by the Department of Justice.

Mr. Chairman, as I said, there may be as many as 5,559 shipping-points where one of these three varieties of reduced competition will be manifested within a short time after Conrail and Norfolk-Southern are merged. It is possible that some of the problems may be solved; or even that others may prove to be less serious than we first thought. The point, however, is that we will not know until a complete and exhaustive study of all of the anticompetitive problems associated with the proposed merger can be ascertained and suitable remedies proposed. To date that has not happened.

Unless this Committee moves to uncover the full facts in this matter before recommending adoption of the Secretary's plan, thousands upon thousands of companies who ship by rail could fall through the cracks and suffer the fate of captive shippers everywhere: decreased flexibility and service, and increased shipping rates. The resulting costs will be passed-on directly to consumers where the market will bear it; in marginally-competitive industries, producers will be unable to pass-on the extra costs and may be forced out of business. We must not allow this to happen.

Mr. Chairman, investigating the full antitrust implications of the proposed railroad merger could take many weeks or even months. A great deal of this Committee's valuable time will be consumed. Fortunately, a second option exists. As I have already stated, I recommend that this Committee reject DOT's proposal as anti-competitive, unwise and unworkable, and proceed instead to consider the public offering as a means of sidestepping the morass of antitrust problems entailed by a sale to Norfolk-Southern.

Under the public offering proposal I favor most, the Secretary of Transportation would be required to use her best efforts to sell Conrail's stock to the public before any other action is taken to return Conrail to the private sector. If the public offering generates a price for Conrail at least as much as the amount pledged by Norfolk-Southern, Conrail would be sold to the public. If the public offering raises less, Conrail would be sold according to an alternate plan prescribed by Congress. Either way, Conrail would be returned to private ownership.

Mr. Chairman, a public offering of the type I've described will save this nation untold time, trouble, and litigation, and give the American people an opportunity to vote with their wallets to settle the Conrail sale debate once and for all. I urge you to consider the evidence I have presented here today and take the first step toward achieving a satisfactory resolution of this matter by voting to reject the Transportation Secretary's proposal on antitrust grounds.

I thank the Chairman and the distinguished members of this Committee for the opportunity to appear before you this morning. I will be happy to answer any questions you may have.

The CHAIRMAN. We are glad to have you with us. Any questions by members of the committee?

[No response.]

The CHAIRMAN. Thank you very much, Senator.

Senator HEINZ. Mr. Chairman, thank you very much.

The CHAIRMAN. I notice the distinguished Democratic leader is attending the meeting this morning and because of his leadership position he has a lot of responsibilities, and if there is no objection I will call on him next.

OPENING STATEMENT OF SENATOR ROBERT C. BYRD

Senator BYRD. Mr. Chairman, I thank you. I will be very brief. Mr. Chairman, I commend you for holding these hearings on the Department of Transportation's proposed sale of Conrail to Norfolk-Southern. The proposal has broad implications for rail service in the Eastern United States generally and the Northeast in particular.

The impacts of the sale will be felt throughout the Eastern United States including my State of West Virginia. My position on the Department of Transportation's proposal will be decided in terms of its implications for West Virginia and the maintenance of competitive rail service in the Eastern United States.

I will be interested in any sound information which will shed light on a number of questions. For example, will the sale of Conrail to Norfolk-Southern be advantageous or disadvantageous for West Virginia? What will be the effect on rail rates and service for West Virginia shippers such as the coal and steel and chemical industries? What impact will the sale have on employment in West Virginia? What impact will the sale have on the Chessie Railroad System which provides hundreds of jobs, thousands of jobs in West Virginia?

Will the new Conrail/Norfolk Southern Railroad be in a position to effectively deny coal mines served by the Chessie System access to markets in the Northeast or will the West Virginia coal industry have improved access to new markets?

These concerns are of course related to the larger issues regarding the competitive effects of the proposed sale. It is my hope that the witnesses who appear before this committee can provide the information necessary to help us to make an informed judgment about the merits or the demerits about the Department of Transportation's proposal. It should also be noted that there are no real alternatives that I think of at this time to the Department of Transportation's proposal.

As I understand the situation, the Senate will be asked to vote on legislation implementing the sale to Norfolk-Southern. Legislation has also been introduced calling for the sale of Conrail through a public offering. However at the present time no one has yet offered a credible proposal for the sale of Conrail through a public offering. I understand there is an effort underway to develop such a proposal. Perhaps the witnesses will provide the committee with information relating to the status of these efforts.

Let me say finally that the return of Conrail to the private sector is an event of major importance to the rail industry and to the economies of a number of States. It would be a major factor determining the future shape of the rail industry in the Eastern United States. It is a complex issue and I hope the hearings which you, Mr. Chairman, have scheduled will contribute to a satisfactory resolution. I thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator BYRD. Mr. Chairman, I do ask unanimous consent that should I have questions for the record that they be included in the record and that the responses to those questions be included likewise.

The CHAIRMAN. The distinguished Senator from Pennsylvania for questions.

Senator SPECTER. Thank you, Mr. Chairman.

Mr. McGrath, the long and short of your testimony is that the proposed sale and merger violates the antitrust laws unless there is appropriate divestiture.

Mr. McGRATH. That is correct.

Senator SPECTER. Is it true that at this moment, you do not know whether or not there can be appropriate divestiture?

Mr. McGRATH. It would also violate the Interstate Commerce Act provisions. We believe there can be, but we do not know whether there will be, obviously, until the divestiture plan is put together.

Senator SPECTER. Well, so at this moment, you do not know whether there will be an appropriate divestiture plan submitted?

Mr. McGRATH. That is correct.

Senator SPECTER. So you are really not in a position to say until you see a specific, appropriate divestiture plan, whether or not the antitrust laws, and the ICC laws will or will not be violated?

Mr. McGRATH. Until we see it and have had a chance to analyze it, that is correct.

Senator SPECTER. Mr. McGrath, how can the Congress be expected to approve a sale when even the experts in the Department of Justice do not know whether or not there will be compliance with the antitrust laws?

Mr. McGRATH. Well, I obviously am not going to suggest how the Congress should do its business. I can only say this: There are many, many situations in which Congress authorizes transactions subject to the competitive approval of the Department of Justice or the Federal Trade Commission. This is our business, to do reviews of divestitures. We do it all the time in many industries.

And to the extent Congress would say, "Fine, this is approved subject to the Department of Justice doing its normal job", I would suggest that that is consistent with a good deal of legislation on the books. I am not advocating it one way or the other, Senator. I am just giving you my view on it.

Senator SPECTER. But the long and the short of it is that you are not in a position to say whether or not there will be an appropriate divestiture plan filed until you see one.

Mr. MCGRATH. Absolutely.

Senator SPECTER. Beyond the issue of whether there will be an appropriate divestiture plan filed, let me retreat to the first question I asked you—whether there can be an appropriate divestiture plan filed. You have specified in your opinion letter that the divestitures shall be made to acquirers who shall have demonstrated to the Department of Justice that they will be able to provide long-term, viable, competitive rail service. Now, is it not entirely conceivable that, given the limited number of acquirers, there may not be such acquirers who can fulfill your standard for long-term, viable, competitive rail service?

Mr. MCGRATH. It is possible.

Senator SPECTER. You just do not know?

Mr. MCGRATH. Well, we do have some information on the subject.

Senator SPECTER. But do you know?

Mr. MCGRATH. Yes, we know it is possible. We do know that because obviously we would not have put this provision in here if we thought it was a futile gesture. We did know a great deal about the competitive realities; for instance, three rail firms have been operating in this market profitably. The business is there. The question is whether the transaction put together with all the financing involved would be sufficient to have another entity or several entities step into the shoes of other firms that have done profitable business.

And I emphasize that the divestiture involves the most profitable part of this area. It does not involve a lot of rabbit trails down hither and yon; the divestiture corridor is the most busy part of the area of overlap in question. I cannot say that we know what is going to happen because we do not even have the divestiture plan yet.

Senator SPECTER. Well, I think that is the point. You cannot say what will happen because you do not have a divestiture plan. It seems to me that the Congress cannot possibly approve a transaction of this magnitude when no one knows, including the experts at the Department of Justice, what is going to happen.

When you talk about certain of the rail lines, and when you talk about outfits like Pittsburgh and Lake Erie, and Delaware and Hudson and others, there are a tremendous number of questions about their ability to fulfill the long-term, viable, competitive rail service standard. Are there not, really?

Mr. McGRATH. Obviously, there are many questions and we intend to ask them all.

Senator SPECTER. Well, all right. It is a congressional judgment. But I just do not see how the Department of Transportation can ask the Congress to approve a sale which has these unresolved antitrust questions when no one knows whether they will be answered, or whether they can be answered.

But let me pursue the question about what kind of a line can provide long-term, viable, competitive rail service. One of the concerns that the Department of Justice has suggested here is that Conrail should not continue to operate as an entity alone through a public sale because the future may be sufficiently precarious, and that Conrail may be back in the lap of the Congress, notwithstanding the very substantial profits which Conrail has made. Would you say that if Conrail were an acquiring line, they would constitute acceptance of your standard of being a long-term, viable, and competitive rail service?

Mr. McGRATH. I would have to answer that this way: It would depend what Conrail was acquiring, what burdens they were taking on in acquiring it, and what the combined competitive situation was with Conrail and the other entity. And I do not think you can answer that question without knowing what the combined entity would be in that case or in the case before the Senate today.

Senator SPECTER. Well, if you cannot answer a question as to whether Conrail would be long term, and viable and competitive, how in the world will you ever be able to answer that question as to the Pittsburgh & Lake Erie Railroad?

Mr. McGRATH. No. I did not say you would not answer the question whether Conrail would be a long-term, viable, competitive carrier. I said I could not answer the question now whether Conrail plus all the divested routes would as a combined entity be a long-term, viable, competitive entity without knowing what all the terms and conditions of the transaction were, including what burdens Conrail would take on as part of the divestiture transaction.

Senator SPECTER. I did not understand your answer because I do not think you understood my question. Suppose the issue here were whether Norfolk-Southern was going to acquire Pittsburgh & Lake Erie Railroad. Then one of the issues is that Pittsburgh and Lake Erie would have to sell off some lines to Conrail. Under the Department of Justice standard that I have just read to you, Conrail satisfy that standard as a proposed purchaser?

Mr. McGRATH. If you assume for a minute that what it was taking on in this transaction was not going to prejudice its business, it did not take on obligations that made it less viable, then I do not have a definitive conclusion, but there is a good chance that it would, yes.

Senator SPECTER. Do you think Conrail might even be able to make it all on its own if it stayed in business as a private entity into 1986 and 1987?

Mr. McGRATH. I do not know the answer to that, but I suspect it would, yes.

Senator SPECTER. Well, the Department of Transportation is really raising that issue in the suggestion which it makes here of Conrail needing a deep pocket like Norfolk Southern. They are really saying to the Congress, in rejecting the public sale alternative, that Conrail is not going to be able to make it.

Mr. McGRATH. I do not think that has quite been their testimony, but I do know that they have raised questions about the long-term future in terms of whether the taxpayers want to risk staying in the railroad business. I think that is quite a different item. But I do not really want to take on an interpretation of the Department of Transportation's view on this.

Senator SPECTER. Well, there is a question as to whether the Government ought to stay in the railroad business, and I do not believe it should. I think it ought to return Conrail to the private sector. And there is a question about what Conrail is worth with the $7 billion taxpayer investment.

But it is quite a separate issue that the Secretary of Transportation has taken here—that there is concern that Conrail may not be on solid enough financial ground to be able to maintain itself as an independent entity. The objection to a possible public sale has been that Conrail just is not solid enough. I mean, that has been their point in rejecting the public sale.

Mr. McGRATH. That the risk factor involved would lead to a situation where you could not get as much from a public sale as you could get from the deal that is on the table; I think that is a little bit different from suggesting that Conrail is about to go out of business.

Senator SPECTER. No, no, it is not that. It is not that we might not be able to sell 85 percent of the stock of Conrail for $1.2 billion. There is a suggestion that, even if we could sell it for 1.2 billion, or as Morgan Stanley has testified, for $1.5 or $1.6 billion, the Department of Transportation is concerned that Conrail is not sufficiently solid as an operating railroad, that it will not be profitable in the future, and it may wind up back in the lap of the Government and the Department of Transportation. That is why the Department of Transportation is looking for a deep pocket like Norfolk Southern.

Now, I pursue this question because I ask you whether, in looking for acquirers like Pittsburgh and Lake Erie, it is conceivable that if Conrail does not measure up to the standard that the Department of Justice has articulated as a solid operating railroad, whether any of these railroads who are potential acquirers can measure up to the Department of Justice's own standard?

Mr. McGRATH. On the basis of our analysis, if a firm like Conrail or any of the firms that have been competing with it in the area cannot survive in the long run, it is because of the long-run competitive pressures in the region that will result in a substantial downturn over time of the volume of shipments and make it unprofitable for three competitors to operate in the region.

Now, if that condition happens, that will mean that right now it makes no sense to continue three railroads in the region, and it will obviously mean that whether that third railroad is Conrail or whether it is X, the new entity that comes in, that either it or one of the others will not survive as a profitable entity in the region because of conditions over time. That is the principal risk.

Our position is that indeed three competitors can survive in the region. Our conclusion perhaps is based on our inate bias in the Antitrust Division that competition is a good thing, and we hate to conclude that you should go to only two competitors unless you really have to.

But the reason why some have been concerned about the extent of risk attaching to the ongoing operation of Conrail is, at least from our analysis, precisely because of the concerns as to whether indeed three competitors can profitably survive in that or any other region in the country in the rail business.

The CHAIRMAN. Your time is up, Senator.

Senator SPECTER. Let me just have one followup, Mr. Chairman. I infer from that answer that you think Conrail could survive given current market conditions and reasonable projections.

Mr. McGRATH. That is correct.

Senator SPECTER. Very good. Thank you, Mr. Chairman.

The CHAIRMAN. The distinguished Senator from Ohio.

Senator METZENBAUM. Mr. McGrath, it is good to see you again. I understand you will be leaving as of Friday.

Mr. McGRATH. Yes, sir.

Senator METZENBAUM. I understand you are going to Dewey, Ballentine; is that right?

Mr. McGRATH. Yes, I am, Senator.

Senator METZENBAUM. When was that announced?

Mr. McGRATH. That was announced in early January, I believe. At least I announced it in early January.

Senator METZENBAUM. A little sensitive question, but does not Dewey, Ballentine represent Norfolk Southern?

Mr. McGRATH. Not to my knowledge, sir.

Senator METZENBAUM. My information is—and I am not certain that I am correct—that Mr. John Salmon of Dewey, Ballentine has been acting as a lobbyist in connection with Norfolk Southern. If I am incorrect on that, I will publicly apologize. But that is the information I received.

Mr. McGRATH. If it is true, I am not aware of it. John Salmon until a few weeks ago was on the staff of the House. If since then he has been doing that, I have not been made aware of it.

Senator METZENBAUM. All right.

The CHAIRMAN. Let me ask you one question on that, though, right here. Has he made any contacts with you about this or tried to influence you in any way on this matter?

Mr. McGRATH. No. I have not discussed it with him or anybody else at Dewey, Ballentine.

Senator METZENBAUM. I respect your integrity and I am not suggesting that—but it seems to me it is a matter that ought to be public if the firm you are going to become associated with does have legal counsel involved in this particular issue representing Norfolk Southern.

Mr. McGRATH. I agree and I would like to know the answer to that also.

Senator METZENBAUM. Please advise me and I would be pleased to make it public that I was wrong.

Mr. McGRATH. I certainly will.

Senator METZENBAUM. Now, coming more specifically to the issue, do you not believe that the ability of a smaller company to enter a market in order to check the monopoly prices of its larger rivals, depends upon the ability of that smaller entry to expand?

And it ties in with whether or not Guilford or P and LE can quickly acquire the steel cars, heavy duty gondolas, special cars for handling automobiles, and whether they have the financial resources to do it because you can always have a divestiture to some small company. The question is: what makes the Antitrust Department feel that in this instance these companies that have not had good financial records in the past are going to be able to compete effectively with the Norfolk Southern?

Mr. McGRATH. Senator, I cannot tell you sitting here that I have a conclusion that I can draw from what I now know. Obviously, it turns on the financial situation after the proposed divestiture, including any additional financing, what business they are able to obtain from the divestiture based on their operating plans and based on the competitive realities and, also obviously, it is based on what facilities they get, including what switching rights.

And I cannot venture a conclusion on the ultimate question here without knowing all three aspects of the background.

Senator METZENBAUM. But knowing that and your answer to Senator Specter that Conrail probably can make it on its own, can survive, how does the Antitrust Division arrive at the conclusion that, A, the merger should not be made unless there is divestiture; and then the divestitures we are talking about are really not to be made to big leaguers but to companies that are having their own economic troubles without making these acquisitions. And I have trouble in following your line of reasoning.

Mr. McGRATH. Well, I am not sure this will help you, Senator, but let me take this crack at it. The mere fact that a given firm has not been profitable in the past does not mean that it would not be profitable in the future if it acquires a profitable business.

In other words, if it has a business opportunity which is profitable given the competitive realities of the opportunity it has and given its financial situation at that time, there is no reason to conclude that simply because a given firm has not been profitable in the past with another mix of business that it will not be profitable in the future with this additional business taken on because of divestiture. One does not follow from the other. Obviously, the past history of a company is something we would want to look at in looking forward into the future, however.

Senator METZENBAUM. When the little grocery store has to compete with the big supermarket chain, it is very difficult to do so, and the probabilities of that little grocery store being successful financially in competition with the bigger company are not that good. And is that not what we have in this instance?

Mr. McGRATH. No. What we have here is if the little grocery store acquired a chain and then competed with other chains, could it succeed? And what I am saying is that if the little grocery store had not been particularly profitable in the past, that does not mean that its management could not operate a chain with better locations and with more chances of profitability.

Senator METZENBAUM. But we do not have a situation that they are getting better locations and more profitability. We have a situation where after the merger is over, as I understand it, Norfolk Southern will still have competitive lines running in the same area and the little companies will be trying to meet the competition of the bigger companies. Am I not correct?

Mr. McGRATH. No, because I think the one thing you have left out is that the new company, which may be a big one or a little one, will have the tracks and the switching rights not only to do business through this territory, but to do business with the shippers all along the lines that it acquires and also to do connecting business with carriers from outside of the region.

The question is whether, once the whole divestiture is put together, that possibility of business is sufficient to engender enough confidence that the resulting entity will be profitable. And I have no conclusion at this time as to whether it would be because I do not know what the divestiture plan will be.

Senator METZENBAUM. Then are you perhaps saying that Congress ought to await further developments with respect to the negotiations between Norfolk-Southern and these other companies and then find your position—and I think Senator Specter was implying this—find what your position is then and after that has been concluded then Congress perhaps should consider this legislation.

But if we do it now and then we are relying solely upon that evaluative judgment that you will be making and it does not give us an opportunity to have a part in reacting to the judgment you arrive at.

Mr. McGRATH. No, I am not, Senator, for this reason. As I understand it, the NERSA, the act in question here, contemplated that in the public interest Conrail would be sold. And, presumably, we are trying to set up a mechanism to do that that is efficient on the one hand, but also provides for protection of the public interest. And all I am saying is it is perfectly adequate and appropriate for the Congress to say that this is approved subject to the Department of Justice's review of this transaction because that is our business. We review huge mergers every week of the year, ones of as enormous or more enormous public significance than this one.

And for the Congress to rely on us to do our job as it does with the vast bulk of other mergers that are not sujbect to some regulatory agency's review seems to me a normal way that Congress conducts business.

Senator METZENBAUM. In the interest of competition, do you think that perhaps Congress, instead of passing this legislation, should reevaluate the decision made some time ago that at a certain point the DOT should sell the railroad? Maybe the railroad should not be sold, as I have indicated in my opening statement. Do you have a reaction to that?

Mr. McGRATH. I have a reaction that overall it is better if the Government gets out of the railroad business, that it permits the railroads to operate in as close to a free market economy as it is possible to operate, given the kinds of accommodations that sometimes must be made because of captive shipper situations, and so on.

Senator METZENBAUM. But here is a railroad that has done exceptionally well under Government direction; actually I guess it has done better than the acquiring company has. I think it has made more money than Norfolk-Southern itself made if my mathematics are right.

Mr. McGrath. It has, after an enormous amount of Government subsidy and after a number of operating tax and other breaks that private enterprise does not have, Senator. That is the price we pay.

Senator Metzenbaum. Why did you not concern yourself with markets for Conrail and Norfolk Southern that account for less than 50 percent of the rail traffic? Is there any other merger that you have considered at the Department since you have been there which was approved where you paid no attention to the combined market share being less than 50 percent?

Mr. McGrath. Yes; that is the normal standard we apply to railroad mergers. It is not 50 percent of market share. It is 50 percent of rail movements. And our analysis, the so-called 50/10 test, as I understand it, has been the one that we have used in rail mergers generally before the ICC. That is not a market share question. It is 50 percent of rail movements.

You then, of course, have to next go to see what intermodal competition there is, and I understand from our experts that, overall, the 50/10 test would be roughly comparable to applying the Herfindahl index that we apply in most mergers. We cannot, of course, apply the Herfindahl index here because we almost never have anything more than rudimentary information on the extent of intermodal movements until we actually go out to a large number of individual shippers to find out more about that.

Senator Metzenbaum. Have you reached any judgment as to whether Guilford or Pittsburgh & Lake Erie or any other group meet the test that Senator Specter referred to, and that is to ensure that the company is able to provide long-term, viable and competitive rail service?

Mr. McGrath. No, sir, since we have not been informed as to who the divestiture parties are and what the plan is, we have done no investigation of the subject, and I have no opinion on it.

Senator Metzenbaum. Mr. Chairman, I do not wish to take any further time. I know Norfolk Southern is here. If I have misstated the facts with respect to Mr. Salmon and Dewey Ballentine representing Norfolk Southern, then I want to apologize publicly for even having asked the question. Am I wrong about that or am I right about it?

Mr. McGrath. Are you asking me?

Senator Metzenbaum. Norfolk Southern, they are back there somewhere. I cannot believe they are not in this room.

The Chairman. They are scheduled to testify.

Mr. Claytor. Senator Metzenbaum, I am chairman of Norfolk Southern. I have not heard of any arrangement, but I am informed that we have retained Mr. Salmon to advise us on technical tax matters but not as a lobbyist. I had not known that, and I think that the actual employment was after the Department of Justice opinion came out.

Senator Metzenbaum. He is with Dewey Ballentine.

Mr. Claytor. He is with Dewey Ballentine, but I had no knowledge of that.

Senator Metzenbaum. I thank you, sir.

The Chairman. The distinguished Senator from Illinois.

Senator Simon. I thank you, Mr. Chairman.

Mr. McGrath, strictly from an antitrust position, an independent sale would be the most desirable; is that correct?

Mr. **McGrath**. When you say an independent sale, do you mean to someone——

Senator **Simon**. A stock offering; set up a Conrail company as a separate entity, call it whatever you will.

Mr. **McGrath**. No; I could not argue with that, Senator. The form of the transaction would not matter. For example, if Conrail were acquired by one of the other finalists that bid against Norfolk Southern, that would raise no more competitive problem than a public offering. The form of the transaction is not the key. The question is whether the acquiring entity is one that is in competition with Conrail. Thus, it was only the Norfolk Southern transaction that even raised a competitive question and that is why that is the only one that we spent any resources reviewing.

Senator **Simon**. But if there were a public offering and United States Steel or some outside entity in effect purchases a good chunk of the stock and the rest is just purchased by pension funds and other things, strictly from the antitrust point of view that is the ideal or is it not?

Mr. **McGrath**. No. I cannot say it is the ideal. It would raise no competitive problems, but if some large corporation that is not in the railroad business acquired Conrail, that would not raise any more competitive problems than a public offering; that is all I am saying.

Senator **Simon**. What is, just for my clarification, where do we stand on the divestiture plan? What would happen is we would pass a bill, the President would sign it, then a divestiture plan would be developed after the bill is signed, and then it would be approved by you?

Mr. **McGrath**. That is not certain. For example, if the divestiture plan were reached in the near future, presumably the Department could deal with it. Whether the final decision on that would be made before or after enactment of the statute remains to be seen.

I do not believe there is any plan other than to go forward with devising a divestiture plan and then seeing whether it would be approved.

The **Chairman**. Senator Simon.

Senator **Simon**. Yes.

The **Chairman**. Senator McConnell has to go to a speech at 12:15; would you mind if we would let him go for a few minutes?

Senator **Simon**. If I could just take 3 more minutes; unfortunately I have a luncheon engagement here, too, Mr. Chairman, if that is all right with my colleague.

The **Chairman**. Is that agreeable, Senator?

Senator **McConnell**. Yes.

Senator **Simon**. All right. And I shall be very brief here.

You mentioned contacting others, the shippers. Were other railroads contacted for their reaction to this?

Mr. **McGrath**. Yes. We contacted or were contacted by a number of other railroads, including in particular the railroads in the immediate area.

Senator SIMON. On the 50/10 test, I think I understand the 50 side of it. What is the 10 side of this 50/10 test you are talking about?

Mr. MCGRATH. The 10 is that one or another of Conrail and Norfolk Southern has at least 10 percent of the revenues in question; in other words, if Conrail and Norfolk Southern had 50 percent of the revenues from rail movements to or from one place but one of them at 49.5 percent and the other had .5 percent, we would say, well, this combination does not raise concentration because the one that had .5 percent is not a meaningful competitive entity now, so that a combination would not matter.

That is why we use the 50/10 test, so that you conclude that together the two of them have a substantial part of the movements, but separately each of them has a substantial part so that a combination of the two may indeed raise a competitive issue. That is why it is 50 and 10.

Senator SIMON. Then a final question: You mentioned contacting shippers; was this a phone call saying what do you think, give me your offhand opinion or did you ask these shippers to really give you an in depth analysis of the effects of this sale?

Mr. MCGRATH. We actually had a questionnaire that went to shippers that asked a variety of questions. In addition, in many cases that was followed up with interviews, either because we knew the shippers presented particular issues to begin with or because the questionnaire responses indicated that more discussion was necessary or because the shippers came to us with particular slants.

In addition, in some areas we actually sent out into the marketplace more broadly and talked to various entities affected. I mentioned the coal situation before. That was an example of that.

Senator SIMON. All right. I thank you very much. Thank you, Mr. Chairman. And thank you, Senator McConnell.

The CHAIRMAN. The distinguished Senator from Kentucky.

Senator MCCONNELL. Thank you, Senator Simon.

Mr. McGrath, in your February 27 statement to the Commerce Committee you indicated that "While there may be some possible anticompetitive consequences in some markets after the sale and divestiture, these anticompetitive consequences are likely to be insignificant."

I have been hearing from an awful lot of rail employees in Kentucky who suggest that the anticompetitive aspects of the merger would have a devastating impact on their jobs, and we are talking here about literally thousands of jobs.

The Railroad Commission of Kentucky maintains that the merger will destroy the competitive balance east of the Mississippi River and if all of these things were in fact to occur I would not consider that insignificant, which leads me to ask you how does the Justice Department define "insignificant"?

Senator SIMON. Mr. Chairman, if my colleague would yield, I would like to ask the witness if it would be possible for us to discuss the questionnaire that was filled out.

Mr. MCGRATH. Yes.

Senator SIMON. I would be interested in getting a copy of the questionnaire, and if it is possible also a photostatic copy of them. You are talking about 200 shippers roughly, right?

Mr. MCGRATH. The questionnaire would be no problem. With respect to a lot of the information we received, we did receive it on the basis of confidentiality. I would have to look at that.

Senator SIMON. All right. I apologize to my colleague from Kentucky, and I promise not to do this again.

Senator MCCONNELL. The question was——

Mr. MCGRATH. Yes, I recall the question.

Senator MCCONNELL [continuing]. How do you define "insignificant" because thousands of jobs lost in Kentucky, if that were to be the result of this would not in my judgment be insignificant.

Mr. MCGRATH. The language in the letter that you refer to really is referring to a numerical point. As I indicated in my opening statement, what we concluded was that after divestiture there would only be $50 million of movement in the area of Conrail and Norfolk Southern overlap that would not be directly dealt with by divestiture. And the word "insignificant" is meant to apply to the fact that that would be a very minor part of the overall revenues of the combined businesses, and balanced against possible gains, that did not seem to us a sufficient reason, less than 1 percent of revenues, to block the merger.

It does not, however, and our analysis did not, go to the question of employment and how many workers of the railroads in question would be employed after the transaction as opposed to before the transaction. It may well be that a given merger of two competitors will result in a situation where after the merger fewer people would be employed by the combined entity and that this would permit the resulting firm to reduce costs.

That is in economic terms an efficiency; that is that the combined entity may be able to reduce costs. We did not look at that situation here in terms of it being a determinative factor.

Senator MCCONNELL. So you have no idea what the impact is on employment.

Mr. MCGRATH. That is correct.

Senator MCCONNELL. Several questions were asked about coal. Let me ask one more; will the mini carriers—I guess that is the appropriate word—which Justice proposes to create from the divested fragments of the Norfolk Southern/Conrail merger have access to any coal mines at all?

Mr. MCGRATH. I would not use the word "mini carriers" because it has not in our mind been determined that it would be a smaller carrier who would be the entity that would step in here. We certainly have not been presented with any such plan.

But laying that to one side, it remains to be seen to what extent the entity that will take on the divested assets will or will not have involvement in coal shipments. I cannot answer that question.

Senator MCCONNELL. So you have no idea.

Mr. MCGRATH. That is correct.

Senator MCCONNELL. Thank you, Mr. Chairman. Those are all my questions.

The CHAIRMAN. Thank you, Senator. If that is all the questions of this witness, he is No. 1; we have eight more. Excuse me, Senator, I did not know you had come in. The distinguished Senator from Iowa.

Senator **Grassley**. Thank you, Mr. Chairman. I am going to submit a statement, Mr. Chairman, because I was late to this hearing due to a conflict. And also I have some questions that I am going to submit in writing that I would like to have responded to. So I would like to ask permission for the statement to be accepted, and I would ask for the record to stay open until I get a written answer to the questions that I am going to ask.

The **Chairman**. Without objection that will be done.

[Statement follows:]

PREPARED STATEMENT OF SENATOR CHARLES E. GRASSLEY

Thank you Mr. Chairman and I look forward to reviewing the testimony that will be given at today's hearing and the hearing scheduled next week on the antitrust implications of the sale of the Consolidated Rail Corporation, known as Conrail, to the Norfolk and Southern Railroad.

Mr. Chairman, I know that you and I share a belief that the free enterprise system is better able to provide to consumers reasonable prices and products or services high in quality than is any agency of government. I think the Reagan Administration should be commended for facilitating the return of northeast rail service to the private sector. This was not an idealogical or a casual decision. Secretary of Transportation Elizabeth Dole conducted an exhaustive study of the northeast rail system and considered a number of alternative means of returning Conrail to private ownership as authorized by Congress in 1981.

S. 638 would facilitate the award of Conrail ownership to Norfolk and Western upon payment of 1.2 billion dollars to the Federal Government for its 85 percent share of the corporation's stock, and an additional amount to those employees who own stock in the Conrail system, together with various tax and employee protection aspects.

The Department of Justice has approved the sale of Conrail conditioned upon Norfolk and Western of divesting itself of smaller lines. As a Senator who's own State's interest in this issue may appear to be minimal, I have not yet reached a decision on the antitrust implications, or those that are under the jurisdiction of other committees, because I believe the record will show ramification of the sale in my State that might be greater than first believed. I therefore look forward to today's testimony.

The **Chairman**. Senator Specter, do you have some other questions?

Senator **Specter**. Yes, I do. Thank you, Mr. Chairman.

Mr. McGrath, on page 8 of the Justice Department letter, there is a reference to a statement that "When an independent rail alternative able to maintain competition within the designated corridors is found, such divestiture would resolve at least $371.4 million of potential problems out of the total of $516.1 million."

When Mr. Claytor presented his written testimony to the Commerce Committee, on page 5 he has outlined that "Selling lines to other carriers diverts to competitors over $100 million in traffic off the combined Norfolk Southern/Conrail system."

Now, I have a number of questions on this issue. The first question is: Is the $100 million range at all adequate when you have called for $371 million out of $516 million?

Mr. **McGrath**. Well, I do not know what Mr. Claytor was referring to.

Senator **Specter**. Have you seen his statement?

Mr. **McGrath**. I have not. The $371 million figure does not mean that there will be $371 million of Conrail or Norfolk Southern revenues that will be shifted to someone else. What it means is, as to shipments amounting to that much money there will be an additional competitor. That additional competitor presumably will get some portion of the $371 million, but one will not know what that amount is until the competitive forces work their way out. The $371 million is not an amount of revenue that would be shifted. It is the amount of revenues as to which there is a competitive problem.

Senator Specter. Well, you are saying that if other competitors are found there will be a resolution of $371 million in revenue, are you not?

Mr. McGrath. That is correct. Let me give you an example. If right now Conrail and Norfolk Southern are shipping $50 million worth of glassware from a city in the middle of Ohio outside of the area, and they were the only shippers, divestiture would provide for another carrier to take over one of the lines of the two and, thus, be in a position to ship out any portion of that glassware because it would be in the same competitive position as Norfolk Southern and Conrail.

That does not mean that the new shipper would take over all $50 million worth of the combined revenues of Norfolk Southern in glassware from that city in Ohio. All it means is that there would be after the divestiture two competitors for that $50 million in revenue as there was beforehand.

Senator Specter. Well, Mr. McGrath, what I am trying to understand here is where will the competition come from, and how much will there be if, in fact, there is this kind of divestiture.

You have made reference in your exhibits to markets and counties, as I understand your documents, with revenue problems of $2 million or more. That leaves a tremendous number of counties which may have very significant problems of $2 million or less.

Then at page 4 of your letter to the Department of Transportation you make a reference to a number of screens that you have used where the total revenues affected were small, or in which major shippers in the market supported the merger. My question to you is: What concerns did you show to the smaller shippers and in counties where you might have less than $2 million involved?

Mr. McGrath. Well, bear in mind that the $2 million figure does not refer to commerce; it refers solely to the fact that those were situations where the total revenues shipments in which Conrail and Norfolk Southern participated were $2 million or less. Their share might have been a great deal less than that.

The reason for that screen was simply this: There are virtually an indefinite number——

Senator Specter. It is $2 million or more; it is not 2 million or less. That is my question. You could have a lot of counties there that your survey has overlooked where you could have less than $2 million, and it would be very, very substantial.

Mr. McGrath. Well, those are two different things. There were two different screens. One was $2 million to $5 million and one was less than $2 million. In the case of the counties that were less than $2 million, as a general matter, we did not do a competitive analysis as to those counties simply because as a practical matter you have to have some cutoff point.

Senator Specter. Well, why?

Mr. **McGrath**. Well, you have to have some cutoff point because otherwise you have an indefinite number of locations, and you know that below a certain amount the overall amount of competition involved is de minimis compared to the commerce involved in the overall transaction.

Senator **Specter**. Well, I wonder about that. It may be de minimis to the Judiciary Committee sitting in this marble palace, and it may be de minimis to the Assistant Attorney General of the Antitrust Division, but it is not de minimis to a lot of counties which are small counties, and a lot of small shippers.

You are calling on us to make a judgment where you have not considered counties with less than $2 million, and obviously a lot of small shippers. I am trying to get an idea of the scope of what your study has included.

Mr. **McGrath**. Well, I did not say we did not make a judgment as to those counties; I said we did not do a case by case analysis as to those counties because there were already so many other larger points that could be looked at to determine the overall competitive reality of this merger.

That was what was done and the divestiture in question covers the area of substantial overlap. You did not need to look at every single competitive situation to learn what the overall competitive reality was. That is the point.

Senator **Specter**. Well, what is the effect, then, in counties, small counties, like many we have in Pennsylvania, and Kentucky, and every other State, where there would be $2 million or less in quantity?

Mr. **McGrath**. As a general matter, a great deal of those counties would be taken care of in this proposal to the extent they are in the divestiture corridor. To the extent they are not, in many cases under the 50/10 test there would not have been sufficient overlap in any event, since a very high percentage of them are now served by only one of the carriers or by neither of the carriers.

So that we knew on the basis of experience that what you would end up with is, yes, you would end up with some very small points, that where applying all of our tests you might come up with a competitive problem. But the amount of commerce that would be involved after all that we knew would be very small.

Now, if the conclusion was going to be if there is any place in the world where there is a competitive problem and the merger should not go through, then obviously under the approach we took we have not—indeed we have proved that there are places——

Senator **Specter**. I would not say any place, but the analysis that you just presented leaves open the possibility that there could be a lot of places.

Mr. **McGrath**. It does; but it does not leave open the possibility that the total amount involved would be substantially different than the $50 million that I referred to at the beginning of my testimony. It would not be in a different quantitative ballpark.

Senator **Specter**. When you use words like "substantiality," as Senator McConnell has pointed out, those words mean different things to different people. They certainly are substantial to small counties and small shippers.

Mr. **McGrath**. That is correct, but——

Senator SPECTER. On your analysis, as you say, they could be left in the lurch.

Mr. MCGRATH. There could be situations where in locations the competitive situation after the merger may indeed change the competitive realities. And what we have said, what I said today, was that could be somewhere up to but probably a fair amount below 1 percent of the combined revenue of these two railroads.

Our judgment was that that was small enough, given the likely cost benefits and competitive benefits, which would probably overcome that less than 1 percent. Nothing is ever dead solid perfect in a rail merger, and what you have to do is look at the overall competitive reality.

Senator SPECTER. I thought as to the cost benefits you testified that you really could not measure—your words as I wrote them down were that you really were not in a position to measure the benefits or savings.

Mr. MCGRATH. You cannot measure them; at least we do not feel we can measure them. But what we can say is that inherent in the situation are enough situations where cost and operational benefits can be obtained, that it is reasonable to conclude that those savings will be in the same kind of quantitative ballpark as the less than 1 percent of revenues that raise competitive queries.

Now, if one makes a judgment that something has to be competitively perfect or it cannot go through, I agree, then, this merger cannot go through.

But the problem with that is we would put ourselves in a straitjacket if that was the kind of merger analysis we were applying.

Senator SPECTER. Mr. McGrath, I do not think we are talking about perfection. I think we are talking about some reasonable assurances. Your testimony says that a lot of counties are left out, that you really are not sure about a lot of situations and you counterbalance that with efficiencies. You have also testified that you are not really sure about efficiencies and economies. I do not know quite where that leaves us except with a lot of unanswered questions.

Mr. MCGRATH. That is not what I have said. I have said that we are confident that the amount of problem revenues is less than 1 percent of the total revenues of the companies. We believe our analysis demonstrates that. We also believe that it is likely that the efficiencies that are there immediately to be had are in that same ballpark, and therefore, net, that this merger competitively overall is not troublesome.

We are sure of that. But if you say to me, Is it 42 million or 61 million; are the efficiencies 51 million or 72 million? I cannot answer that question. I can only tell you the rough range, and I would suggest that anyone who tells you he can mathematically give you a certain answer as to either the competitive problems or the efficiencies is either an awful lot smarter than all of us are or is talking through his hat.

The CHAIRMAN. Senator, your time is up. We have nine witnesses; we are still on the first witness. I wonder if you have more questions you could put them in the record.

Senator SPECTER. Mr. Chairman, I do have a lot of questions in writing to be asked. These questions are not easy, and there is a lot of followup which is necessary. I am not at all satisfied with where we are with this witness on these issues. This is the man who has submitted the letter sayinq that it is going to pass antitrust muster if, as, and wherefore. I am used to legalese, but I am hearing a lot of it today.

The **Chairman**. You may not be pleased with his answers, but I guess he has done the best he could.

Senator **Specter**. Well, I am pleased with his answers. I just have some more questions.

The **Chairman**. How many more? [Laughter.]

Senator **Specter**. It very much depends on his answers.

The **Chairman**. Well, if his answers do not please you, are you going to keep on?

Senator **Specter**. No, no. I have a number of subject matters to cover, Mr. Chairman. I think he is the witness before the committee on these antitrust questions.

The **Chairman**. All right. Take 10 more minutes.

Senator **Metzenbaum**. Before the Senator from Pennsylvania does, may I interject one question, please?

Mr. McGrath——

Senator **Specter**. I would be glad to yield, but not on my time, Senator Metzenbaum.

Senator **Metzenbaum**. It is my understanding that I get 10 minutes of my own.

The **Chairman**. You are entitled to 10 minutes now, if you want it.

Senator **Metzenbaum**. I know that Senator Specter meant that, even though he did not say it.

The **Chairman**. He has a right to alternate, Senator.

Senator **Specter**. Of course.

Senator **Metzenbaum**. Mr. McGrath, I just have one question. I have a document before me that I understand was supplied by Conrail, which is a comparison of the P&LE, Guilford, and combined Conrail/Norfolk Southern System. And it indicates the working capital at the conclusion of the merger, if there is to be one, and the divestiture.

In the 4 years you have been at the Antitrust Division, do you have any recollection of ever being involved in any divestitures that satisfied the Department, whether it had to do with Socal and Gulf or had to do with any one of a number of major divestiture requirements that the Department has imposed over a period of years, where the company to which the divestiture was being made had over $65 million in net working capital deficit, but this was considered to be a viable kind of divestiture? That is what the Pittsburgh and Lake Erie has.

According to this figure, its 1984 working capital current assets minus current liabilities is $65.3 million. Now, I came out of the business world before I came here; that company may be able to survive for a number of various and sundry reasons, but I would not think that that was a very viable kind of divestiture from the standpoint of protecting those who use that railroad and being assured that that service is going to be continued on into the future.

And it concerns me that the Department of Justice has not addressed itself to the net working deficit of P&LE as well as the deficit of Guilford, which is smaller But there is a deficit.

Mr. McGrath. Well, Senator, we have not addressed ourselves to it because we have not been given a proposal.

Senator Metzenbaum. But you do not need a proposal. I am not talking about a proposal. You have talked about it being divested, as I understand it, to the P&LE and the Guilford.

Mr. McGrath. I have not.

Senator Metzenbaum. The Department has not mentioned that at all?

Mr. McGrath. I have not. If we have, I do not know who has.

Senator Metzenbaum. Well, is that not the two companies to which the divestiture is to be made if and when there is a divestiture?

Mr. McGrath. That may be the plan, but we are not involved in putting together the plan. Once the plan is put together it will come to us. Perhaps it will be those entities. Perhaps it will not. I do not know.

Senator Metzenbaum. If you saw a divestiture being made to a company with a $65 million net working capital deficit, would you not agree that that is not a very viable divestiture as far as protecting the future competitiveness of that particular operation and the continued service to those people who will be transferred over into that company's operations?

Mr. McGrath. Well, I am not going to comment hypothetically on this particular divestiture because I have not seen the plan. I have not seen that document. So I do not know.

Senator Metzenbaum. You do not have to see the document. Based upon my representations I am telling you Conrail says P&LE has a $65 million net working deficit, and I am saying to you, knowing that, would you not as the head of the Antitrust Division have to conclude that that is not the kind of viable divestiture that satisfies the concerns of the Antitrust Division?

Mr. McGrath. All I can say is that, if that is the only fact I knew, I would have to know more facts.

Senator Metzenbaum. I have no further comment. Thank you.

The Chairman. The distinguished Senator from Pennsylvania.

Senator Specter. Let me pursue that. [Laughter.]

We will give you some more facts. The facts are that there were three railroads negotiating to purchase these lines. One is Grand Trunk, which has dropped out, and they are going to testify here later. Another is Pittsburgh and Lake Erie, and the third is Guilford. Pittsburgh and Lake Erie in 1984 had a loss of $11.6 million. It also has a deficit of $65.3 million.

Guilford, besides having a problem with an intermediate line, has income of $2.8 million and has a deficit of $1.1 million.

They are going to be going up in competition, if this sale/merger is approved, with Conrail/Norfolk Southern, which has $982.4 million in net income and working capital surplus of $1.5 billion.

Now, the problem that I have, Mr. McGrath, in looking at whether it is possible to have an acquirer under your standards—long term, viable, and competitive—if these are the only railroads around, and we have asked these questions, how can you possibly, remotely, conceivably, under any set of circumstances, have an acquirer who is going to be competitive to tangle and compete with this new giant?

Mr. McGRATH. Well, Senator, the past working capital deficit does not answer the question. The question is, What is the future? What will the cash-flow and other economic results be in the future? And if the future is to be profitable enough, if sufficient lines of credit are available, and so on, then it may very well be that the resulting entity will be one that has a high chance of being profitable. I cannot answer that question today. I do not know what the deal will be.

Senator SPECTER. Well, that is fair enough. If you cannot answer the question, I do not think the Congress can answer the question either. We just do not have a state of the record, or any assurances that the standards which you have set forth in your letter can be met, or that there can be a merger which will satisfy your requirement that there be adequate divestiture under your standards of competitive, long term, and sound.

Mr. McGRATH. The thing you can be assured of is that when the divestiture plan is submitted, the Department of Justice will do an appropriate job, an objective job, of reviewing it under the standards that have been set forth in our January letter.

Senator SPECTER. Mr. McGrath, you testified earlier about the Herfindahl-Hirschman index not being applicable here because, as I understand it, you said that there would have to be a check into more intermodalities to be able to use that standard.

That standard is the one which is characteristically used by the Department of Justice on mergers as a general rule.

Mr. McGRATH. It is, but not in railroad mergers.

Senator SPECTER. Well, which railroad mergers has it not been used in since 1982 when the Department of Justice issued its 1982 horizontal merger guidelines?

Mr. McGRATH. Well, for instance, it has not been used in the Santa Fe merger that is pending right now.

Senator SPECTER. Well, why should it not be used as a standard which is used in other business mergers?

Mr. McGRATH. Because it is impossible to use it. If we had a steel merger we know what companies are competing, say, for sheet steel. We can determine their shares of the market and then you take each company's share of the market, you square it, and then you add up the square of each of the shares. That is the index.

Here you cannot do that because we do not have information on who the competitors are when we start. We know who the rail competitors are from the 1983 waybill sample, and so on. But we do not have sufficient information on trucking and barge competition to and from individual points without going out and obtaining it.

Senator SPECTER. Well, why not go out and obtain it?

Mr. McGRATH. Well, indeed, that is what we then do. We go out as to—here what we did is we took the principal shippers and went out and obtained from them and other sources intermodal competitive data so that we could determine as well as we could what the shares of shipments of a given commodity to or from a given location were, in fact, competed for by truck or by barge and, in particular, where we could ascertain it, to what extent price movements of one of those modes or another, a small but significant price increase, would indeed result in movements from one mode of transportation to another. That is the normal test we apply.

Senator SPECTER. Well, if you went out and did it, then why could you not apply the Herfindahl-Hirschman index?

Mr. McGRATH. In some individual markets we did end up with enough so that you could construct Herfindahls as to that market. But we did not go through that exercise because in many cases we could not do it; indeed, in most cases we could not do it. We still did not end up with enough data as to all the competitors to do it.

Senator SPECTER. Well, why could you do it in some and not in others? It might take more time, but if that is the traditional standard, why not approach it in the traditional way that you judge the mergers by your 1982 guidelines?

Mr. McGRATH. Because we would end up in only a few situations where we would have that data, and therefore we did not go through the HHI methodology. Instead, we looked at market share methodology which is what we and the ICC have done in railroad mergers.

Senator SPECTER. You talked about coal before—I have a great many questions that I am just going to have to skim the surface of—and you talked about the corridors which are involved here, and you talked about the corridor from Buffalo to Pittsburgh, and one from Chicago to St. Louis. I am told as to western Pennsylvania coal that Norfolk charges $16 a ton to ship it, and Conrail can ship it through the port of Philadelphia in the $11 to $12 range. Coal producers in my State are very concerned that that is going to make them noncompetitive, that it will have a material effect on their ability to compete for overseas markets. The balance of trade problem is an issue here.

Would you consider that a substantial factor militating against this sale?

Mr. McGRATH. We did not find in the course of our analysis any facts that indicated that indeed there was a competitive problem with respect to those shipments.

Senator SPECTER. If my facts are true, what would you say then?

Mr. McGRATH. Well, what we have done is we have received a good deal of information from a number of people in that business and have looked at the actual competitive facts. We would be happy to do so if you have any particular situations you would like us to look at.

Senator SPECTER. Well, what is your thought if it costs $4 a ton more to ship western Pennsylvania coal? You have not taken the corridor that goes east of Buffalo-Pittsburgh. There is a lot of the country east of Buffalo-Pittsburgh.

Mr. McGRATH. Well, we have taken it because we looked at all origin and destination points in the country. What I am saying to you is I cannot respond to a particular pair of freight rates and tell you sitting here what our analysis was as to those particular things. I do not have it memorized.

Senator SPECTER. Well, that is one of the additional questions which I will submit to you that you can consider after today. It is very hard, Mr. McGrath, to sink into specific hard facts as we go through the testimony today.

So let me return to these statistics which are as close to any hard facts as I can find in the documents at hand—the $371.4 million, and the $516 million, and Mr. Claytor's statement about $100 million—which is what is on page 8 of your letter.

"When an independent rail alternative able to maintain competition within the designated corridor is found, such divestiture would resolve at least $371.4 million in potential problems out of a total of $516.1 million in the markets we have identified."

The first question is: Why is it sufficient to resolve only $371 million when $516 million is at issue?

Mr. **McGrath**. Well, I did not say it was. What I indicated previously was that as to over $90 million of the remaining shipments, those involved shipments from outside of the area of such products as pulpboard and fiber board, and so on. And our analysis indicated that the vast bulk of those shipments went to the divestiture corridor where the principal markets for those products are.

Senator **Specter**. The divestiture corridor?

Mr. **McGrath**. Yes. And that opening up the gateways that would be opened up by this divestiture would permit as much competition for those shipments as exists today. And that is why I indicated that there was only approximately $50 million of revenues left that we cannot account for as being protected directly in the divestiture proposal.

Senator **Specter**. Well, how do you contrast your statement that the divestiture would resolve at least $371.4 million with what Mr. Claytor has said here in the range of $100 million?

Mr. **McGrath**. I already told you that I gathered from what you said that he was talking about the diversion of revenues. That is not what the 371 refers to. It refers to competition as to those revenues.

Senator **Specter**. Mr. McGrath, do you see any problem if the Congress did not deem this sale to be approved by the Interstate Commerce Commission?

Mr. **McGrath**. Well, I am not—are you saying that——

Senator **Specter**. Well, there is a provision in the bill which really grants an antitrust exemption.

Mr. **McGrath**. Yes.

Senator **Specter**. I think it would be useful to explore for just a moment the differing roles of Justice and the Interstate Commerce Commission. You deal with the Sherman Act and the Clayton Act, obviously. Your letter also takes into account the Interstate Commerce law.

Mr. **McGrath**. Yes.

Senator **Specter**. What would be wrong with deleting that protection from Norfolk Southern and saying that they will have to pass muster at the Interstate Commerce Commission like anybody else?

Mr. **McGrath**. I think there is one major problem with that. Congress in the NERSA statute indicated that a methodology should be set up for selling Conrail. And that methodology does not include ICC review.

It does include review, among other things, by the Department of Justice and then review by Congress. You have to balance on the one hand the ability of the Government to do what may be in the public interest, that is, to privatize Conrail against the public's interest in having that review done in an efficient fashion. I would suggest that having had the review by the Antitrust Division, which has been an independent review, and having the oversight in Congress that has followed, that to add on to that a year or two or three of ICC reviews and court reviews is not to serve the goal of adequate public scrutiny of the transaction. It is rather to serve the goal of so delaying the transaction that you may well succeed in scuttling it. I think that is my bottom line.

Senator SPECTER. Well, what of the functions which the ICC performs?

Mr. McGRATH. The functions which the ICC performs in normal rail situations where there is a merger between two private corporations is to approve or disapprove the merger. The Department of Justice—I say usually; I suspect always—participates in that review on the competitive issues. Now, it may well be appropriate for the ICC to consider issues beyond the economic issues of competition in that review, although Congress, as I read the Staggers Act, did not think that was appropriate. But here to the extent it is appropriate for issues beyond competition, the economic issues of competition to be considered, labor issues, or others, Congress is here to consider those issues. I gather you are considering those issues.

And so I would raise the question, "Why put a redundant time-consuming, additional layer of review on this where you will not improve the competitive or other analysis?" All you will do is tie it up with additional lengthy, redtape type-proceedings.

Senator SPECTER. Well, that is the issue. Is it redundant? Is it redtape? Does the ICC perform a useful function in general?

Mr. McGRATH. They perform a useful function in general, but in a normal situation they make the overall judgment.

Senator SPECTER. If so, why not here?

Mr. McGRATH. Here, instead, the overall judgment was made by the Department of Transportation assisted by our competitive analysis, by the Treasury Department's tax analysis, and then that judgment is being subjected, and I think rightly so, to the full review by Congress to determine what issues should be applied and whether that judgment should indeed be agreed with.

Having done that, I would suggest that the ICC would be worse than redundant.

Senator SPECTER. You are not suggesting, are you, Mr. McGrath, that the Congress, in the course of these very brief hearings, can give the kind of piercing, analytical review which the ICC does, as you put it, in months or years?

Mr. McGRATH. No, I am not saying that. I am saying that the combination of the enormously extensive review that the Department of Transportation has given, that we have given, that the Treasury Department has given, added to all the briefings of many Members of Congress, plus these hearings, to me, is adequate to protect the public interest. You can due process this thing to death and perhaps kill it, but I would suggest that would not be in the public interest.

Senator SPECTER. Mr. Chairman, I shall submit the balance of my questions in writing. Thank you very much, Mr. McGrath.

The CHAIRMAN. Thank you, Senator. Senator Laxalt and Senator Denton have some questions, and will you answer those for the record?

Mr. McGRATH. Yes, sir.

The CHAIRMAN. And any questions from any other Senator, if you will answer those for the record.

Mr. McGRATH. Yes, sir; we would be happy to.

The CHAIRMAN. Senator, I do not want to dismiss this witness now until you are completely satisfied. Are you satisfied now or do you want more time?

Senator SPECTER. Mr. Chairman, I am not completely satisfied.

The CHAIRMAN. Well, go ahead. Why don't you ask him right now.

Senator SPECTER. All right.

Mr. McGrath, in order to assess the anticompetitive effect of Norfolk Southern's acquisition of Conrail, the Department of Justice first identified those markets in which the proposed merger would have significant adverse effects under its so-called 50/10 test. Does not the 50/10 test exclude from scrutiny those markets where one carrier has less than 10 percent of the market, but where the other carrier has an enormous proportion of the market?

Mr. McGRATH. That is correct.

Senator SPECTER. So that the net effect where you have 50/10 is that one carrier might have 9 and the other might have 70, but the 50/10 test does not take into account the total market which would be consumed by that kind of a merger.

Mr. McGRATH. That is correct. And where we thought that was a problem we did do some additional analysis to see whether sort of the fluke of mathematics would result in there being problems of that sort and did not find any on any broad basis.

Senator SPECTER. Well, how many markets did you take a look at which were subject to that sort of a fluke, as you characterize it?

Mr. McGRATH. I do not know the answer to that. I would have to supply that for the record.

Senator SPECTER. Would you please.

Mr. McGRATH. Yes.

Senator SPECTER. In such circumstances, Mr. McGrath, does not the acquisition of a carrier with a smaller market share by a dominant carrier really increase the potential of anticompetitive harm?

Mr. McGRATH. I do not know how to answer that. It does not if overall the proper steps are taken in the analysis.

Senator SPECTER. After you applied the 50/10 test, as I understand it, the Department of Justice then proceeded to reduce this group of problem markets by virtue of a number of assumptions. I would like to understand how those reductions were arrived at.

First, the Department states that it eliminated those markets where nonrail competition appeared to be significant. My questions are: What were those markets and how did the Justice Department decide what constituted "significant nonrail competition"? Were any studies performed on this matter?

Mr. McGRATH. Yes. As I indicated before, we obtained information on intermodal competition from a variety of sources and then applied certain percentage screens to that. Rather than testing my memory as to the precise mathematics of the screens, I would prefer to provide that for the record.

Senator SPECTER. When the Department of Justice stated in your letter that the number of problem markets was further reduced to eliminate markets in which the total amount of affected revenues was small, or major shippers in the markets supported the merger, my questions are: How many and which problem markets were eliminated because of the value of revenues affected, and where was the cutoff?

Mr. MCGRATH. The cutoff was $2 million, and I explained the rationale of that before. I do not know the exact number of markets that covers, and I would have to supply that for the record.

Senator SPECTER. Well, do you have an idea as to how many there were of the so-called problem markets?

Mr. MCGRATH. I do, but not enough of one to want to testify to it.

Senator SPECTER. Are you in a position to say how many, and which of the problem markets were eliminated because the major shipper in the market supported the merger?

Mr. MCGRATH. Not exactly enough. I would like to supply that for the record.

Senator SPECTER. Why the emphasis on the major shippers, Mr. McGrath, as opposed to an analysis of shippers more broad than the so-called major shippers?

Mr. MCGRATH. Well, there were a number of reasons, but to me this is something we decided on early in the analysis. There obviously is no way we could go to all the shippers that ship on these two railroads. We simply could not do that.

What we tried to do instead was to figure out what kind of a sample would give us adequate information to answer the overall competitive questions that we had and to supply the additional information we needed. That was how we decided on the 200-plus major shippers on the theory that having talked to them we would get a good overall picture of the market.

Senator SPECTER. Well, what consideration then was given to the smaller shippers?

Mr. MCGRATH. In some cases we obtained data on smaller shippers because we focused on particular commodities. That was true with respect, for instance, to some agricultural commodities—soy beans, corn, and so on. It was also true with respect to coal because some of the coal shippers would not have been, I think, within the largest 200.

So that in the case of given commodities where other questions were raised for various reasons, we obtained other information. But the main thrust was to go to the 200-plus large shippers to get an overall competitive picture.

Senator SPECTER. Well, how many smaller shippers, then, did you consider?

Mr. MCGRATH. I do not know how many we considered. There obviously are tens of thousands of smaller shippers.

Senator SPECTER. Well, the way you describe it is that it really worked out incidentally, when you were looking at product lines, that you picked up the smaller shippers.

Mr. McGRATH. Incidentally only in the sense that the major thrust was to look at the larger shippers who comprised over 3 percent of the movements of these two railroads.

Senator SPECTER. Over 3 percent?

Mr. McGRATH. Over 3 percent, I believe.

Senator SPECTER. Did the smaller shippers then constitute the balance of the 97 percent?

Mr. McGRATH. The shippers other than the 200-plus, many of whom are large shippers, comprised, I believe, 96 point something percent of the movements of these two railroads.

Senator SPECTER. Well, what I am trying to get a feel for is the consideration which comes out of your study as to the small shippers of which there are so many. We have 2,300 shippers in Pennsylvania. I have had a series of hearings in Pennsylvania, and big shippers and small shippers alike are concerned. Your study seems to have taken into account the big shippers. What I am trying to get at are the conclusions you came to as to small shippers, even though you may not have particularized the 200 or any other special number.

Mr. McGRATH. The conclusion is that overall the kind of pattern that we saw with the bigger shippers would not have been different if we used a different sample. At least I know of no basis for concluding it would have been, and thus that the divestiture proposed would solve the problem to the same extent for both groups of shippers.

Senator SPECTER. Well, you know of no reason that it would have been different, but do you have any affirmative evidence that it would have been the same?

Mr. McGRATH. The only affirmative evidence is that we did an enormous amount of looking at these markets in various ways and our conclusions are based on all that.

Senator SPECTER. What methodology was employed, Mr. McGrath, in your letter to the Secretary which recognizes potential anticompetitive harm from the merger only in markets which are currently served by both carriers? Is it not correct that markets served only by one of the merging rail carriers can suffer serious adverse effects from such a rail merger?

Mr. McGRATH. It seemed to us very unlikely that if both railroads were not in fact serving an area, had not recently been serving an area, that the railroad not serving an area was a meaningful competitive force.

Senator SPECTER. Let me give you an example that you might focus in on. You recognized in your letter in footnote 4 that, "The proposed Norfolk Southern/Conrail entity would have the market power to increase its switching rates and effectively foreclose a third carrier from competition."

Nevertheless, the letter to the Transportation Department does not attempt to evaluate the harm that would result or might result from these increased switching rates. The question is: Did Justice make any study of Conrail and Norfolk Southern switching practices, and if so, what were the results of such a study?

Mr. McGRATH. Well, Senator, the part of the letter you refer to is the part of the letter where we are saying that this transaction, but for divestitures, would in our view not be appropriate competitively. And obviously through this investigation, and through other knowledge that our people have of the rail business, they knew enough to conclude that this problem of switching rates was one that would possibly lead to competitive problems.

Our main answer to this was to say that in the areas principally impacted by the parallel merger, new competition would have to be put in so that you would end up with the same number of competitors.

Senator SPECTER. Can you talk to Senator Heinz' example of somebody shipping from the South, the hogs coming to Washington, DC, and you have to find another line to compete with the merged Conrail/Norfolk Southern? That comes right back to the point as to whether you can find lines which would be competitive and viable.

Mr. MCGRATH. And that is why what we insisted on was that where we found competitive problems after our point-to-point analysis, gateways would have to be opened up so that there would be this alternative. I cannot testify this morning about the shipment of hogs from Georgia to Washington and what the competitive realities of that is. I can only say that where we found a sufficient increase in concentration without sufficient other competition from other modes of transportation, that was included in our problem areas or problem revenues.

And that was what led to the outlines of the divestiture proposal that we put in the January letter.

Senator SPECTER. I will just ask one more question now, Mr. Chairman, and submit the balance of the questions for the record. But I think this is really a critical question. I would appreciate it if you would supply, after you talk to other people, whether you know of any other rail lines which may acquire branchlines. Because if we are correct that we are only talking about the limited opportunities which we have discussed with you here today, then I think Congress is in a position to make a judgment. I would suspect that the judgment would be pretty compelling that we would find Pittsburgh and Lake Erie and Guilford insufficient.

So I would appreciate it if you would make an inquiry as to whether there are other lines which are possible to provide this competition that we have come back to again and again today.

Mr. MCGRATH. Are there other lines or nonrailroad firms, I would assume, because bear in mind, two of the finalists in the Norfolk Southern transaction were nonrailroad firms.

Senator SPECTER. Well, if they are in a position to acquire these lines through divestiture. I do not think they are, if you are talking about Alleghany and Marriott. I do not believe they are in the picture.

Mr. MCGRATH. I am not suggesting they are. I am just saying in answering the question if there were others who were nonrailroad——

Senator SPECTER. Absolutely. I do not care who they are as long as they are in the picture to be acquirers of these lines under the standards which you have articulated. If you find others besides Pittsburgh and Lake Erie and Guilford, I would appreciate knowing why they have not surfaced up to the present time in all the studies which we have made.

Mr. McGRATH. Very good.

Senator SPECTER. Thank you, Mr. McGrath. Thank you, Mr. Chairman.

Mr. McGRATH. Thank you, Senator.

The CHAIRMAN. Thank you, Senator. We have eight more witnesses. Six of them are railroad witnesses from out of town. Is Mr. Rooney here and Mr. Ross? I am just wondering if it would not inconvenience you gentlemen too much if we could take the railroad witnesses next starting at 2 o'clock since they are from out of town. Would that suit you gentlemen if we take them next. Is that all right?

[No response.]

Thank you very much. What we are going to do then is the first witness when we come back will be Robert B. Claytor, chairman and chief executive officer of Norfolk Southern. So we will take a recess now and be back at 2 o'clock.

[Whereupon, at 1:03 p.m. the committee adjourned to reconvene at 2 p.m. that same day.]

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order.

Our next witness is Mr. Robert B. Claytor, chairman and chief executive officer of Norfolk Southern Corp. Mr. Claytor, come forward.

Mr. Claytor, we are glad to have you with us. You may now proceed.

STATEMENT OF ROBERT B. CLAYTOR, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, NORFOLK-SOUTHERN CORP., NORFOLK, VA, ACCOMPANIED BY J.R. TURBYFILL, EXECUTIVE VICE PRESIDENT, FINANCE; J.S. SHANNON, EXECUTIVE VICE PRESIDENT, LAW; AND D.H. WATTS, VICE PRESIDENT, CORPORATE DEVELOPMENT

Mr. CLAYTOR. All right, sir. Before I begin my prepared statement, I would like to supplement the record with regard to the answer which I gave to Senator Metzenbaum concerning John Salmon, whom I find upon investigation was hired by Norfolk-Southern as a tax attorney on March 4 of this year, he having joined the Ballantine firm about February 1. I understand that in the course of his duties as a tax lawyer he will probably have to register as a lobbyist, so he may properly communicate with the staff. And I would like the record to reflect that.

The CHAIRMAN. Thank you.

Mr. CLAYTOR. Mr. Chairman, I am here today not as an antitrust expert; I am here to give you my views as a railroader on the competitive aspects of the Conrail sale. I am proud to have been a railroader for a number of years.

As we all know from the testimony this morning, the recommendation that Secretary Dole has made to the Congress has been reviewed by the Department of Justice. And we furnished a tremendous amount of detailed information for them. Our policy was to cooperate fully with them, and I think we have done that.

Certainly, the Department of Justice took a rigorous approach. It required a divestiture involving over 1,500 of line and access to hundreds of millions of dollars of Norfolk-Southern and Conrail revenues. Justice, by and large, required that all significant markets combine to be served by the same number of rail carriers.

Mr. Chairman, including Conrail in a strong interterritorial system, as we are proposing here, is really the last piece of unfinished business remaining from the restructuring and revitalization of the railroad industry which has been taking place during the past decade. This restructuring has left shippers better off for a reason which really goes to the very heart of this business. The more traffic you can put on single lines of railroad, the better job you can do hauling it and the cheaper you can haul it.

Mr. Chairman, the railroad industry is faced with very pervasive competition from the motor carriers, and unless we are able somehow to cut our costs, our share of traffic is going to continue to decline, and the railroad industry will decline also.

Joining Conrail and Norfolk-Southern, aside from permitting more efficient and thus more competitive service offers a whole new competitive geography to shippers. I will not go into all of the details, but I would point out that cities such as Philadelphia, Baltimore, Dayton, Lansing, and Youngstown will gain a railroad which can for the first time compete with the great CSX system for single-system business to and from the south.

I could give you many more examples, but I will hold this for the questioning, if any.

I also want to comment very briefly on the proposed divestitures which we have heard about this morning. Norfolk-Southern is presently working with Guilford and we are coming close to reaching a definitive divestiture agreement. All along the lines it acquires, not just in the markets of concern to the Department of Justice, Guilford will have access to all industry which was served by Norfolk-Southern and Conrail. Guilford will offer jobs and provide New York dock protection to employees on the lines it acquires. It will obtain an inplace, operating railroad system from Buffalo to Chicago and St. Louis at a cost that is only a little more than the value of the steel in the rails.

Mr. Chairman, as you can see on the map which we put up there, one of the routes being divested includes NW's first-class main line from Buffalo to Cleveland. This is track with heavy rail, centralized traffic control, and it is modern in every respect.

Then trackage rights bridge the short gap from Cleveland to Crestline, OH and from there the route continues on the old Pennsylvania Railroad mainline via Fort Wayne all the way to Chicago. That line is in good shape, too. As a matter of fact the Amtrak train runs over it at very high speeds.

Another line branches off at Delphos in western Ohio and continues directly to St. Louis. Finally, to complete a sort of *X* pattern, the Pittsburgh and Lake Erie can acquire a route from Cleveland to Pittsburgh and also additional lines that extend north to Toledo and south to Indianapolis.

A final competitive issue concerns the impact of the affiliation on our friends at CSX. Now, CSX says in a general way that NS/Conrail will be bigger than CSX to the northeast, and, gee whiz, they just will not play ball on those terms. I have already mentioned that CSX is considerably bigger than Norfolk-Southern in the southest, with 50.7 percent of the car loadings compared to Norfolk-Southern's 29.5.

Now, Norfolk-Southern obviously finds it worthwhile to compete in the Southeast, and in the Northeast—the so-called eastern district—NS/Conrail will be bigger overall than CSX. The car load proportions in that district are 50.9 and 29.6. But overall a fair balance exists.

Mr. Chairman, Congress has shepherded the resurrection of rail service in the Northeast since 1973. Now is the time to close the book on this project. The studies and deliberations have been full and far reaching, particularly on the issue of competition. The Justice Department has never had such a free hand in a railroad case, and I have seen many. Never have such major divestitures been required. Congress is the proper judge of the result.

It has already decided that rail service in the Northeast should not be left to administrative or judicial decision. In both the 3R Act and NRSA, Congress itself has made the key policy decisions. This hearing and others like it create a formidible record which itself comes at the end of a long, perhaps a too-long consideration.

Any more delay has a real human cost without adding anything to the positions of the parties. Congress' first and foremost objective since 1973 was and remains to ensure continued rail service in the Northeast. Joining Norfolk Southern to Conrail accomplishes this objective and at the same time creates an improved competitive structure in the American rail network east of the Mississippi. Thank you very much.

[Statement follows:]

STATEMENT OF ROBERT B. CLAYTOR, CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF NORFOLK SOUTHERN CORPORATION

Good morning. I am Robert B. Claytor, Chairman and Chief Executive Officer of Norfolk Southern Corporation. On February 8, Secretary of Transportation Elizabeth H. Dole accepted Norfolk Southern's offer to acquire the government's stock in Conrail. I am here today to comment on the competitive aspects of this affiliation.

Let me first summarize the major features of the sale. Norfolk Southern will pay $1.2 billion cash to the government for its 85% interest in Conrail and will pay $375 million for employee interests and claims. The purchase price of the stock will come entirely from Norfolk Southern, not from Conrail. No Conrail cash is used and no Conrail assets are pledged. In addition, for five years Norfolk Southern has agreed to continue Conrail service, to maintain Conrail properties, to see that $350 to $500 million a year goes into capital expenditures, and to refrain from taking more than 40% of Conrail's income as a dividend, and then only if Conrail keeps a $500 million cash cushion.

In short, Conrail, in addition to gaining the benefits of affiliation with Norfolk Southern, is left in the strongest possible position. At the same time, Norfolk Southern and its customers will gain the market access and geographic coverage afforded by Conrail. Frankly, it is these mutual benefits, and not Conrail's unaided earning power, which enable us to pay the price and make the commitments we have made.

In looking at the competitive issues, I am not here as an antitrust expert. What I have to offer is a railroader's view of competition in our industry and the effect on it of Norfolk Southern affiliation with Conrail.

Our own assessment of possible competitive issues focused on places where Norfolk Southern and Conrail serve the same businesses. There, we looked at individual shippers and individual stations which are actually served by both NS and Conrail. We found only 12 significant NS shippers (shippers with three or more cars a day of NS business) which would go from service by two railroads to service by one. The 12 represent only eight separate customers because one appears twice; another, four times. One of them, Ford Motor Company, is one of the strongest supporters of the combination, an indication of how far the transportation benefits outweigh any hypothetical competitive impact.

Similarly, we found only six significant communities (those where all shippers together produced 10 or more carloads a day of NS business) which would go from service by two railroads to service by one. These six were Ft. Wayne, Indiana, Bedford and Fairlane, Ohio, the Steubenville area of Ohio, one Ohio coal mine and one Indiana utility.

This amount of overlap, even before the divestiture required by the Department of Justice, is minuscule in the context of a 30,000 mile railroad. After divestiture, it almost disappears. Seven of the 12 shippers will retain competitive service, and three others have come out publicly for the unification. We felt, even before taking into account the divestiture, that the combination was consistent with the balancing test applied to railroad mergers, particularly since the 4-R Act reforms. The 4-R Act reflected a growing realization that the public interest in merger efficiencies can outweigh the arguable disadvantages of having fewer railroads. Following this Congressional philosophy and leadership, our industry, with the exception of Conrail, has regrouped into five strong and efficient interterritorial systems: BN/Frisco, UP/MoPac, Chessie/Family Lines, NW/Southern and perhaps Santa Fe/Southern Pacific.

Last year on September 11 Secretary Dole referred our proposal to the Department of Justice for analysis.

The Justice Department asked us for a large amount of data, primarily traffic data. We furnished the information it requested. A number of follow-up requests came in. For example, Justice asked for the names, addresses, and telephone numbers of dozens of shippers, large and small, both on and off our system.

In every case we furnished all the information we had which Justice requested. Our policy was to cooperate fully with the study.

As the study progressed, Justice had additional questions about specific markets. In addition to supplying data, we made available our appropriate people to respond.

In general, Justice took a rigorous approach. We have accepted and are implementing its divestiture requirements, but the amputation is drastic - virtually amounting to an entire railroad, the bulk of the old Nickel Plate. Over 1500 miles are involved, and access to hundreds of millions of dollars of Norfolk Southern and Conrail revenues. Justice by and large required that in all significant markets the same number of rail carriers be maintained.

As I said, we will comply. For the record, however, I'd like to give my own observations on rail competition. To begin with, it has little to do with the number of railroads operating in a market. I can remember when there were a dozen -- actually dozens of -- routes between Chicago and the East. But was there strong competition? By no means. If you were a shipper, you would have paid the identical rate on each route. When the rate was adjusted via one route, it was simultaneously adjusted via all the other routes. The cliche' is that railroads competed on a service rather than a price basis, but in fact that multi-railroad structure could not even support good service. Almost every year the rail share of the market went down.

What was worse, the traffic fell far short of what was needed to operate all those routes efficiently. The railroads' financial condition got worse and worse. The condition of the track got worse and worse. The so-called rail competitive alternatives open to shippers became more and more meaningless.

Finally, the system collapsed. Most of the railroads in the region entered bankruptcy. Instead of poor service under a supposedly competitive regime, shippers faced the real possibility of no rail service at all.

With direction from Congress, DOT and USRA made some pathbreaking studies. I won't cite these documents at length, but let me summarize the conclusions. Strong rail competition is not a function of the number of railroads in a market. Trucks provide significant competition. Service by multiple railroads is not essential. A one- or two-railroad structure permits concentrating shipments in frequent, properly sized trains. It also permits concentrating investment in only the necessary number of lines, instead of spreading it over several underutilized lines. By achieving these efficiencies, the railroad becomes a stronger, better competitor.*

These conclusions were accepted by Congress. They underlie Conrail's present structure. In part, they explain Conrail's success. By and large, main-line Conrail shippers, even those without any other rail alternative, seem pleased with Conrail service and not at all lonesome for the Reading, CNJ, Lehigh Valley, or whomever.

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*United States Department of Transportation, Rail Service in the Midwest and Northeast Region (1974), pp. 2, 12-13. United States Railway Association, Preliminary System Plan, (1975), pp. 108, 121-22. United States Department of Transportation, A Prospectus for Change in the Freight Railroad Industry (1978), p. 81.

The same analysis is valid in other parts of the country. Two big railroads serve Canada. The Mountain Pacific and Pacific Northwest regions of the U. S. are for the most part served only by BN and UP. The Santa Fe/Southern Pacific merger will produce a two-railroad structure in much of Texas and California.

In the Southeast, Norfolk Southern and CSX, two large, strong systems, compete head-to-head. Competition is intense because both systems operate on the scale necessary to sustain it. To take a single industry as an example, we are continually battling CSX and trucks for paper traffic at Franklin, Virginia, Savannah and Brunswick, Georgia, Charleston, South Carolina, Mobile and Montgomery, Alabama, Jacksonville, Florida and Plymouth, North Carolina. When we acquire Conrail, we're going to compete with CSX like Coke fights Pepsi. That's why CSX is so opposed to the acquisition - because it will lead to heightened competition. Even without divestitures as radical as required by Justice, Norfolk Southern's acquisition of Conrail would improve competition. It would create for most of the country east of the Mississippi something like the pattern prevalent in the Southeast: two financially secure, geographically large railroads investing heavily in plant and fighting for traffic and new industry. Economic growth in the Southeast has hardly suffered under this regime. In fact, our strong railroads are an incentive to attract new industry. I should also mention that CSX is considerably bigger than Norfolk Southern in the Southeast, with broader coverage, but that has not stopped competition because both are solid interterritorial systems.

Including Conrail in a strong interterritorial system is the single major piece of unfinished business remaining from the restructure and revitalization of the American rail industry in the past 10 years. Ask yourself whether shippers were better off 15 years ago with a multitude of sick railroads and paper routes than they are today with only a handful of strong Class I railroads and fewer, but more effective, routing choices.

The reason they are better off today with fewer railroads goes to the very heart of this business: The more traffic you can concentrate on one railroad, the cheaper you can haul it.

This general view applies with particular force to Norfolk Southern operations in important parts of Conrail territory.

We are down to a train a day to and from Pittsburgh, two trains a day to and from the Buffalo interchange.

Even further west, in central Ohio, our traffic density is less than one-fifth of Conrail's. That level of utilization does not let us compete in the same league as Conrail.

Joining Norfolk Southern with Conrail, aside from permitting more efficient and thus more competitive rail service, offers a whole new competitive geography to shippers. Right now we move lube oil from New Orleans and tires from South Carolina all the way to Washington, D. C., but they then go by truck to a Conrail destination because the business is not attractive to Conrail standing alone. People in Philadelphia, Baltimore, Dayton, Lansing, Youngstown and other cities will gain a railroad which can for the first time compete directly with CSX for single system business to and from the Southeast. Northeastern utilities will have a much larger number of mines from which they can draw coal on a single system basis, and also a greater diversity of coal, particularly including low sulphur coal. Northeastern ports will have better access to some of the major grain producing areas in the Midwest. Conrail's own grain will move more freely into the Southeast. In a word, Conrail will no longer be bottled up in a single region. Conrail's shippers will gain the same competitive benefits which have forced every other major railroad system in the country to find an interterritorial partner.

All this would be true even with no divestitures by Norfolk Southern. Divestitures add another element of competition, and I would like to give you a report on the present status of the divestitures. As you know, an agreement in principle has been announced with both Guilford and P&LE. We have agreed with these railroads on the exact trackage and routes to be transferred. The transfer is designed not only to cover the markets required by DOJ, but also to provide effective and efficient operations between these markets and the gateway cities.

We are now working on a definitive agreement with Guilford. You may be interested in some of the other provisions. Guilford is for the most part simply stepping into Norfolk Southern's shoes. All along the lines it acquires, not just in the DOJ's markets of concern, Guilford will have in addition to local industry, access to all industry which was served by Norfolk Southern and Conrail. Guilford will have effective terminal access in Chicago and St. Louis. It will offer jobs and provide New York Dock protection to employees on the lines it acquires. Guilford will pay net liquidation value for the lines. It will thus obtain an entire in-place operating railroad system from Buffalo to Chicago and St. Louis for little more than the value of the steel in the rails.

As you can see on the map, the route being divested includes NW's present main line from Buffalo to Cleveland.

This is first class track with heavy rail and signaling. Then trackage rights bridge a short gap from Cleveland to Crestline. From there the route continues with the old Pennsylvania main line via Ft. Wayne all the way to Chicago. Another line branches off at Delphos, in western Ohio, and continues directly to St. Louis. Finally, to complete a sort of X pattern, P & LE can acquire a route from Cleveland to Pittsburgh. Additional lines extend north to Toledo and South to Indianapolis. The associated yards and service facilities are being transferred along with the track.

We have worked very hard with Guilford and P&LE to carry out both the letter and the spirit of Justice's divestiture requirement. Joint inspections of the lines (except Conrail lines) were made. Wherever questions arose, for example, concerning the most effective way to operate into and through a terminal, our operating people have worked directly with their counterparts to find the best way to go. We, of course, want to proceed with Conrail, and Guilford and P&LE have a once in a lifetime opportunity to reach out to new gateways in the west. So both sides have the will to make this transfer work.

A final competitive issue concerns the impact of the affiliation on CSX. CSX says in a general way that NS/Conrail will be bigger than CSX in the Northeast, and CSX won't play ball on those terms. I have already mentioned that CSX is considerably bigger than NS in the Southeast, with 50.7% of carloadings compared to NS's 29.5%, with just about the same preponderance on both the coal side and the merchandise side. Other railroads (but not Conrail, which of course doesn't operate in the Southeast) have the other 20%. Norfolk Southern obviously still finds it worthwhile to operate in the Southeast. In the Northeast (i.e., Eastern District) NS/Conrail will be bigger than CSX; the carload proportions are 50.9% and 29.6%. Attached is a chart which shows, by a number of standard yardsticks, how the disparity between CSX and NS is reduced by this transaction. Overall, a fair balance results. If size is the issue, CSX has nothing to complain about.

It is unfortunate that CSX has chosen to cast its competitive arguments in terms of a threat to pick up its marbles and go home. The restructuring process is unsettling enough for all our employees without CSX threats. That simply doesn't advance the rational consideration of the issues.

I have been through a number of railroad mergers, most recently the Norfolk and Western/Southern unification. With the best of intentions, a certain amount of uncertainty is unavoidable. The unkindest thing any of us can do is intentionally provoke these anxieties like CSX or unnecessarily prolong them.

Congress has shepherded the resurrection of rail service in the Northeast ever since 1973. Now is the time to close the book on this project. The studies and deliberations have been full and far-reaching. Particularly on the competitive issue, the Justice Department has never had such a free hand in a railroad case. Never has such a major divestiture been required.

Congress is the proper judge of the result. It has already decided that rail sevice in the Northeast should not be left to administrative or judicial decision. Both in the 3-R Act and in NERSA, Congress itself made the key policy decisions. This hearing and others like it create a formidable record which itself comes at the end of a long -- perhaps too long -- consideration. Any more delay has a real human cost without adding anything new to the positions of the parties.

Congress' first and foremost object since 1973 has been and remains to ensure continued rail service. Joining Norfolk Southern to Conrail accomplishes this object and at the same time creates an improved competitive structure for the American rail network east of the Mississippi.

THE DISPARITY BETWEEN THE TWO MAJOR EASTERN SYSTEMS IS REDUCED WHEN NORFOLK SOUTHERN JOINS CONRAIL

Subject of Comparison	Disparity Pre-Acquisition CSX	 NS	 Post-Acquisition NS+CR	 CSX
Miles of Road	143%	100%	125%	100%
Revenue Tons Originated*	157%	100%	97%	100%
- Merchandise	171%	100%	100%	100%
- Coal, Coke, Ore	145%	100%	94%	100%
Revenue Ton-Miles	145%	100%	121%	100%
Originated Carloads*	163%	100%	106%	100%
- Merchandise	169%	100%	118%	100%
- Coal, Coke, Ore	156%	100%	89%	100%
Number of Ports	200%	100%	86%	100%

In several categories, NS+CR is still smaller than CSX. In the others, NS+CR is bigger than CSX, but by a smaller margin than CSX is now bigger than NS.

Required divestitures, which will reduce the size of NS+CR, are not reflected in these statistics.

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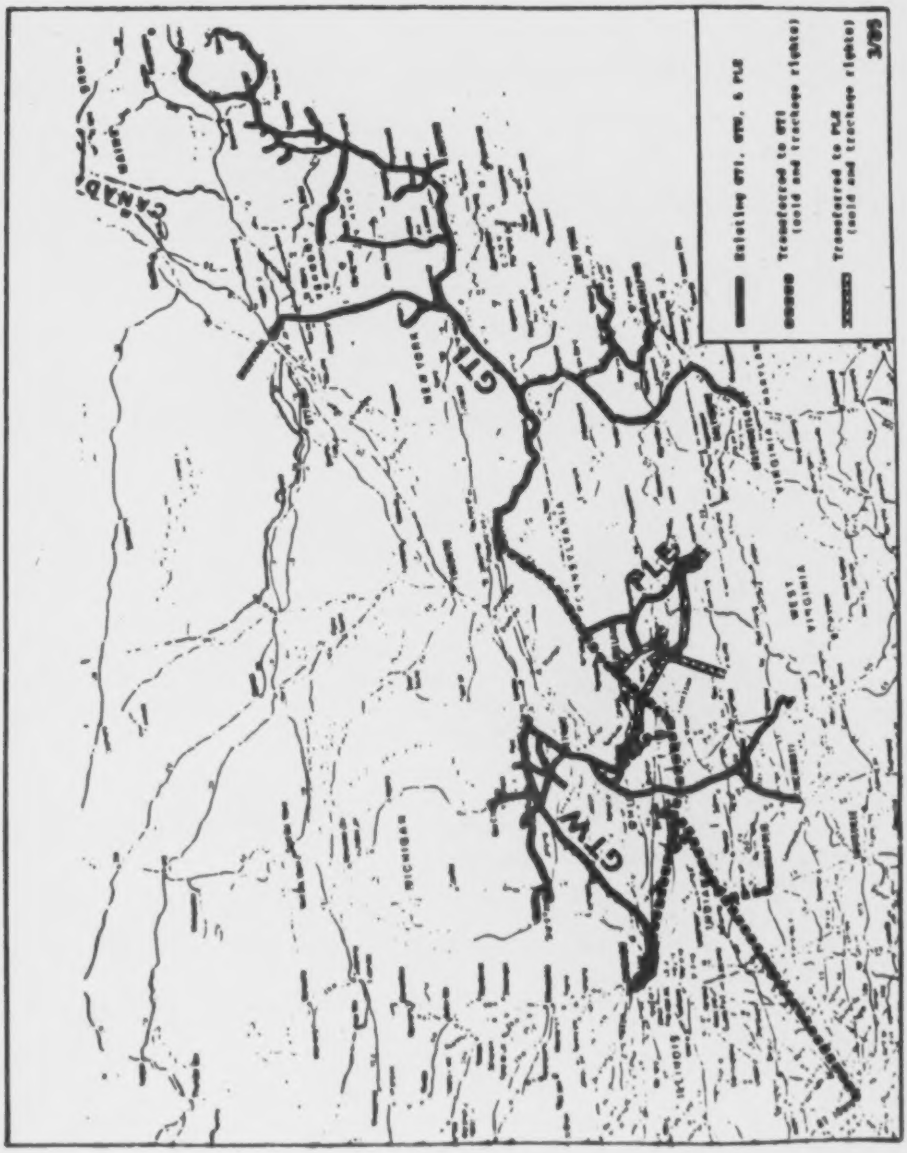
*QCS for 1983


CANADA
GTI
NEW YORK
PENNSYLVANIA
PLE
MICHIGAN
GTW
INDIANA
ILLINOIS
WEST VIRGINIA
VIRGINIA
MARYLAND
Existing GTI, GTW, & PLE
Transferred to GTI (sold and trackage rights)
Transferred to PLE (sold and trackage rights)
3/85

The CHAIRMAN. Mr. Claytor, I believe you were the head of the Southern Railroad for years, were you not?

Mr. CLAYTOR. No, sir. I was the head of the Norfolk and Western which was the other railroad that joined with Southern in creating Norfolk Southern.

The CHAIRMAN. Were you not the head of the Southern Railroad at one time?

Mr. CLAYTOR. No. My brother, W. Graham Claytor, Jr., was the President of Southern Railway and he is now the president and chief executive officer of Amtrak, which is a whole new set of problems. [Laughter.]

The CHAIRMAN. You are brothers but a different Claytor.

Mr. CLAYTOR. We get along reasonably well for brothers, Mr. Chairman.

The CHAIRMAN. I was just thinking when I looked at you that you had changed somewhat; you did not look exactly the same. [Laughter.]

Mr. CLAYTOR. Mr. Chairman, I will take that as a compliment and not tell my brother. [Laughter.]

The CHAIRMAN. Mr. Claytor, could you describe the benefits of competition accruing from the Norfolk Southern/Conrail merger. You mentioned market access and geographic coverage in your written statement. How do these effects benefit consumers?

Mr. CLAYTOR. The benefits to the consumers will be that we will be able to compete on a head-to-head basis with CSX in the markets in the northeast. Norfolk Southern's rail subsidiaries, NW and Southern Railway have been frozen out of the whole Northeastern section of this country by the actions of CSX and Conrail so that we cannot effectively complete in that area.

The Northeast, as you all know, is the most populous area of our country. The smokestack industries are declining, and the railroad industry must increasingly compete with other modes to transport consumer goods. We do not get into the Northeast. We will be able to provide cities such as Baltimore and Philadelphia single-system service to and from the South in competition with CSX, and that is bound to be good for the consumer. It is bound to give us lower overall costs.

And, Mr. Chairman, in the long run, no matter what you say two things depend on costs and business. First, jobs follow the freight, and second, without freight your costs are going to go higher. You have to have more business in order to get your volume up to the point where you can get your unit costs down. And that is what we are proposing, to be more efficient.

The CHAIRMAN. Mr. Claytor, you mentioned the benefits to competition that come with larger scale operations. What benefits from size will Norfolk Southern enjoy after the merger that Norfolk Southern does not now enjoy?

Mr. CLAYTOR. I did not understand. What benefits?

The CHAIRMAN. Of size.

Mr. CLAYTOR. Of size?

The CHAIRMAN. Yes.

Mr. CLAYTOR. There are some benefits of scale which accrue to a larger organization. One person can handle a job where on a smaller railroad it would have to be duplicated. And there are some savings that take in the sales force, Mr. Chairman.

The one thing we propose to do is to unify Norfolk Southern and Conrail sales forces immediately so that it would not be necessary for shippers to be burdened with salesmen coming from Conrail, NW and Southern; one man will speak with one voice for all of them. That is the kind of savings that come from size and economies of scale.

The CHAIRMAN. Mr. Claytor, who chose the rail lines to be divested to solve the antitrust problems identified by the Justice Department? If the divested lines are underutilized how could they be used by a purchaser to replace competition eliminated by the overlap of Norfolk Southern and Conrail?

Mr. CLAYTOR. The lines which we are proposing to divest are frankly for the most part excess or duplicating lines and they fall into a natural pattern. They are also the lines in which the acquirer has shown interest. For instance, Mr. Chairman, NW's first-class line between Cleveland and Buffalo is going to be made available. That line duplicates mile for mile the main line of Conrail just to the north of it. It is a fine line but it will no longer be needed after this consolidation.

I might say that that line to Buffalo is also underutilized by Norfolk Southern. We are down to a couple of trains a day on it. And if this consolidation does not take place, if we cannot get Conrail into our family as we hope we can, that line will probably have to be abandoned as being uneconomic. But the proposal here is that we incorporate that line and many others like it—and they are good lines—into a new system which would be taken over by Guilford and P&LE.

The CHAIRMAN. The Justice Department divestiture plan requires that the acquiring firm must have access to interconnecting railroads at certain gateways. Can you describe how Norfolk Southern is guaranteeing such access.

Mr. CLAYTOR. I do not know that I can give you the technical answer to that, Mr. Chairman, except to say that at the gateways involved, which I understand are Buffalo, Chicago, and St. Louis, we will make tracks available so that the acquiring companies will have a direct connection with either the local switching lines or with the trunk line which would handle the freight out of the gateway. So we would cooperate fully. We are obligated to do that. We will do it.

The CHAIRMAN. I will now turn to the distinguished Senator from Ohio, but before doing that you point on your map there about some lines concerning Ohio. It might be well for his benefit if you would briefly rerun that portion.

Mr. CLAYTOR. Well, Mr. Chairman——

The CHAIRMAN. If you would get up there and point them out like you did before.

Mr. CLAYTOR. There is a line beginning at Buffalo which goes to Cleveland and then it goes with trackage rights over a first-class line of Conrail to Crestline, OH. Then it goes west from Crestline, OH on the main line of the Great Old Pennsylvania Railroad, which is the Amtrak route, all the way into Chicago.

There is also a line which branches off of that and goes down to St. Louis. That was a line of the old Nickel Plate Railroad that NW acquired in 1964. There are also lines of the old Wheeling & Lake Erie Railway which begin up in the vicinity of Toledo and with a combination of trackage rights first and then Salem Line and goes on down into southern Ohio with a branch to Zanesville and it goes on and connects with the line of what used to be the Pittsburgh & West Virginia Railway into the Pittsburgh market in Connellsville.

That is a general description of the lines about which we are negotiating and close to reaching an agreement.

Senator METZENBAUM. I am told that there are a number of communities in Ohio that will suffer a lesser amount of service if the merger goes through. Would you address yourself to that point?

Mr. CLAYTOR. Senator Metzenbaum, I do not believe that to be the case. We want to give more service, and we want to serve everybody that has business to offer us. We do not get any money unless we get business. And with these divestitures that we have talked about, we have in effect an end-to-end merger more than a side-by-side merger.

And we want to give good service to everybody in Ohio. We want to give them the most competitive rates we can. And we want to do that as soon as we can. And I do not think it will hurt anybody in your State, sir.

Senator METZENBAUM. Well, the P&LE is not strong financially. What portion would you be divesting in that map to them? And would they then be without—excuse me. Would you pull out of those areas?

Mr. CLAYTOR. Yes, sir. To answer the first part of your question, the Pittsburgh & Lake Erie would get what is now the green on this map. It is a little hard to see, I am afraid.

Senator METZENBAUM. How much of that do they now have?

Mr. CLAYTOR. The Pittsburgh & Lake Erie is shown in black, their present line. Let me make a couple of comments about that. The P&LE may not be as strong as Citibank in New York, and I am sure I should leave this to them, but I will just tell you this.

Senator METZENBAUM. Citibank may sue on the basis of that statement.

Mr. CLAYTOR. They could buy us, too. I am being a little facetious, sir. The Pittsburgh & Lake Erie at the present time, in my opinion, has a pretty dismal future unless it can break out of its shell and get connections to important parts of the country. It simply is a leftover piece of the old New York Central. It does not go very far. But we are proposing to sell it lines of railroad which in my opinion will give it a very, very fine chance to become a viable, competitive railroad. And I think this is its chance to succeed.

Senator METZENBAUM. What kind of money will they be paying you for it?

Mr. CLAYTOR. Under our proposal, they will pay the net liquidation value for our line, which is in effect the salvage value less the cost of removal if we had to tear it up ourselves. And it is a very low figure comparatively speaking. The exact figure has to be worked out, but net liquidation value is the basis on which we have agreed to sell these lines both to the P&LE and to Guilford.

Senator METZENBAUM. As an expert railroader, even with the acquisition by the P&LE and the acquisition that the Guilford would take, would you not agree that it is a very highly calculated risk as to whether or not either of those railroads are going to be able to make it in the future?

Mr. CLAYTOR. Well, no, sir, I would not. I would like to tell you a little bit why I feel that way. There are three or four reasons. I think the people who are proposing to buy the lines are not only serious, but also have a very good chance of making it. Nothing is certain in this life, as you know.

But I think the odds are very, very good that they will succeed. In the first place, they fill in our shoes. Whatever we had they take. Now, they take that as a base. And that may not be enough. But it might be. But they can build on that because in the first place there is a community of interest between these railroads.

You see the Grand Trunk Western on the map. The GTW will be able to connect with the Pittsburgh and Lake Erie. Now, the GTW, representatives of which I think will be testifying this afternoon, will tell you that road is part of a major system in Canada. GTW is no weak sister. And the P&LE will also connect with Guilford so that they have an opportunity which they have never had before to develop new traffic.

Now, shippers tend to divide their business. If they are served by two railroads, they tend to divide it on some basis, 50-50 or 60-40. If a third railroad comes into the market a shipper, generally speaking, will give the third railroad some share of its business. And this new railroad can expect to get a share of this. Believe me, I wish they did not have to.

Senator METZENBAUM. But as compared to Conrail, Conrail is an aggressive competitor, are they not?

Mr. CLAYTOR. Oh, yes, sir.

Senator METZENBAUM. Yes, sir. And P&LE and Guilford have to be considered sort of weak sisters as compared to Conrail. And you are a businessman. Anybody would rather have somebody like P&LE or the Guilford compete with them rather than having Conrail compete with them.

Mr. CLAYTOR. There are all kinds of ways of measuring strength. And I will tell you a story about that.

Senator METZENBAUM. But also answer my question.

Mr. CLAYTOR. All right. I hope to answer your question. Back 100 years ago or more an executive of a small railroad in the south put in a request for a pass from one of the larger eastern railroads. His railroad was 10 miles long and I think the other one up north was about 3,000. And he asked for a pass. And the CEO of the big railroad wrote back and asked, "Why should I give you a pass? You are only 10 miles long and I am 3,000."

And the answer came back, "Well, you may be 3,000 miles long, but we are just as wide as you."

Now, Senator, there is a message in that. These railroads are just as wide. They have some real advantages. We are selling basically pared down mainlines. They are not burdened with a lot of branchlines. They are not burdened with a lot of excess employees. And they will be flexible and they will be able to make rates just as well as we can. Rates control a lot of business. You know, IBM is a big, big company, but Apple is not doing badly.

Senator METZENBAUM. You did not answer my question yet.

Mr. CLAYTOR. I am sorry, sir.

Senator METZENBAUM. Would you not rather compete against two companies like P&LE and Guilford instead of having to compete against Conrail. I mean, be very honest about it.

Mr. CLAYTOR. I am being honest. In some instances, yes; in some instances, no. The hungry railroads may be tougher to compete with than the big boys. We found that out some years ago when the smaller railroads would cut the rates, and some of the big ones would not. But back in the days when we had rate bureaus and everybody had to argue it out and there was not any competition, then, Senator, as you know; so my answer is yes in some cases, no in some cases.

Senator METZENBAUM. You know, I come from Cleveland where the Robert Youngs and the Cyrus Eatons and the Van Swearingens and all of them were gobbling up railroads as if they were going out of style. They owned everything. I guess they owned you probably at one time. I am not sure if they owned you.

Mr. CLAYTOR. They owned a piece of what we presently own.

Senator METZENBAUM. They owned the Chesapeake and they owned the New York Central and Pennsylvania. And yet it did not work out well. Now we have a situation where Conrail in my opinion is doing one heck of a job. And I am not one of those who is sitting here saying, well, let us get it out and sell it in the market. OK. Congress said you are supposed to sell it; what Congress can do Congress can undo. It is going well. And these people say, well, Government ought to get out of the business. In this instance, however, it has done far better than private ownership. And for the life of me, other than the fact that there was something in the bill early on saying we should get out of it, that the Government should get out of the business, I believe that the Nation and the shippers and the country generally will be far better served if Conrail remains in business.

And I am having difficulty with three points. One is I do not know why we are selling this thing. If it is not broken, do not try to fix it. And right now it is going pretty well. We have one thing in Government that is making $500 million. Let us get rid of it. That is dangerous; we will really be in a problem if we do not get rid of it.

The second thing is that the whole question of service and jobs to the areas that we are involved in. And the third thing has to do with I came out of the business world, and I look at this price and I just think you have the biggest steal that I have ever seen. And I do not blame you at all. If I were in your position and I could buy it for $1 billion I would. But I think $1.2 billion for this railroad with $800 million cash, $250 million surplus pension, $3.2 billion available for depreciation——

The CHAIRMAN. Well, your time is up.

Senator METZENBAUM. I know. I am going to give up the floor in just a moment, Mr. Chairman.

Mr. CLAYTOR. I am not sure I can satisfy you on all those, Senator, except to say that I wish I shared your optimism that it is such a great bargain. I am betting my whole company that the biggest deal that it or any railroad, I guess, has been in will succeed. I think it is no sure bet. And the question really comes down to whether Conrail, not this year, not next year, but in 4 or 5 years or in 10 years is going to be back on the dole again. It is not broke now, but it is wearing out.

And this is the time for the Government to sell it and to get the maximum dollar. And I will say one other thing, and then I will be quiet on this question. It is basically unfair to Norfolk-Southern's loyal employees and Conrail's loyal employees for Congress to drag this thing out. Conrail personnel know that probably they are going somewhere, but they do not know where, and they have heard a lot of scare talk. There has been a lot of scare talk in Ohio. There has been a lot of scare talk in Kentucky and in West Virginia. And if you added them all up it would be the world's greatest disaster since the flood.

But it is not going to happen that way. But a lot of people think it is, and the longer this is dragged out, the longer people are going to be upset and the longer employees are going to wonder whether they have a job, and I do not think that is right.

Senator **Metzenbaum**. Twenty-two lobbyists have spoken to me about this deal. Not two Ohioans have indicated they want the deal to go through, as far as I know. I mean as far as individual working people are concerned.

Mr. **Claytor**. I want a chance to talk to them, Senator. I tried to talk to the Governor out there, but he had another problem. I am going to go back; I am not going to give up. Perhaps I have not done the selling job I should, but I am not going to quit.

Senator **Metzenbaum**. Mr. Chairman, I would like a second round after the others.

The **Chairman**. The distinguished Senator from Pennsylvania.

Senator **Specter**. Thank you very much, Mr. Chairman. Mr. Claytor, you are proposing to sell to Guilford and Pittsburgh and Lake Erie on the basis of net liquidation value?

Mr. **Claytor**. Yes, sir.

Senator **Specter**. That is a fair price?

Mr. **Claytor**. Sir?

Senator **Specter**. That is a fair price, that liquidation price?

Mr. **Claytor**. I think it is unfair to us, but I think it is fair to them, certainly.

Senator **Specter**. Well, you are certainly paying less than that to acquire Conrail, are you not?

Mr. **Claytor**. I do not know that to be the case. I would doubt it. But I do not know that. In any case, Senator, we are buying Conrail on the basis of its earning power and on the basis of our continuing obligation to provide service in the great State of Pennsylvania and the Northeast. We want the right to do so, and we are not buying Conrail to sell it.

Senator **Specter**. Well, let us examine that, Mr. Claytor. You are selling to Guilford and Pittsburgh and Lake Erie on the basis of net liquidation value, and you say that is very fair to them but not fair to you as the seller. So that, if anything, net liquidation value is less than the seller ought to get from a buyer.

Now, why should the U.S. Government sell to Norfolk for less than net liquidation value?

Mr. CLAYTOR. If the United States wanted to sell it to us as a scrap dealer, I would agree with you.

Senator SPECTER. You are not selling to Pittsburgh and Lake Erie as a scrap dealer.

Mr. CLAYTOR. We are selling lines because the Department of Justice said we had to.

Senator SPECTER. You would prefer not to sell them at that because that is less than it is worth?

Mr. CLAYTOR. I would prefer not to sell it, but I understand that not to be a realistic position.

Senator SPECTER. Because it is less than it is worth?

Mr. CLAYTOR. That is basically right. I think if I peddled it on the open market in my leisure I might get more.

Senator SPECTER. And I think if the Department of Transportation peddled Conrail on the open market at its leisure it would get more, too. You are paying less than what you say it is worth.

Mr. CLAYTOR. No, sir.

Senator SPECTER. Well, you explain it to me, then.

The CHAIRMAN. Well, let him answer.

Mr. CLAYTOR. If they peddled it on the open market in pieces here and there they might well get more. And we would bid for the piece that we wanted and CSX would bid for the piece that it wanted, and the people in Pennsylvania would be left with shambles. What we are proposing to do is to include Conrail as a full partner in our rail system.

And we would be proud to have Conrail, and we would be proud to serve the people in Pennsylvania. I think we can give them good service and competitive rates.

Senator SPECTER. The people in Pennsylvania would be left with shambles? You brought up the subject—what is going to happen to the headquarters in the city of Philadelphia? Has Norfolk-Southern acquired any other headquarters in its recent history?

Mr. CLAYTOR. The headquarters of Norfolk-Southern's two operating railroads are in Atlanta, GA, and Roanoke, VA. And our corporate headquarters at Norfolk are very small. It has 160 people. I have said again and again that we would be out of our mind even to talk about moving the headquarters of Conrail.

In the first place, we need a headquarters in the Philadelphia area. We are moving into the Northeast and hope to be a competitive factor up there. And if we do not have a major headquarters there we hurt ourselves. Second, it makes no economic sense whatsoever to move people from Philadelphia. We will not do it; we cannot do it. We want to be welcome in Philadelphia as a new Fortune 500 company, not as someone coming up to steal Conrail. We do not want to steal Conrail. We want to come to Pennsylvania.

Senator SPECTER. Well, Mr. Claytor, you might be out of your mind to talk about moving the headquarters. I could understand that. But might there not be some efficiencies down the road after 5 years and a day, say?

Mr. CLAYTOR. There may be efficiencies down the road for Conrail alone and for Conrail with us. I cannot say what lies down the road. But I will say we plan always to maintain a major headquarters in Philadelphia. It makes no sense to do anything else.

Senator SPECTER. Mr. Claytor, let us get back to the selling price. You say you think that it is unfair that you have to sell to Pittsburgh and Lake Erie at net liquidation value. Explain to me why it is fair for Norfolk and Southern to pay less than net liquidation value to the U.S. Government for Conrail.

Mr. CLAYTOR. I do not think the net liquidation value concept, for whatever use it may be in other contents, has any relevance at all in the context of our acquiring a railroad of the size and scope of Conrail, which is a major burden as far as what we have agreed to do to operate it, to maintain service, to keep it a viable railroad. And this will ensure that Conrail is not being sold to us for liquidation. And I do not think it has any relevance.

Senator SPECTER. You say it is a major burden for you to acquire Conrail?

Mr. CLAYTOR. There are many——

Senator SPECTER. Let me finish the question, if you would, please. Why are you acquiring what you classify as a major burden?

Mr. CLAYTOR. Because we hope and believe that the benefits both to us and to the shippers will outweigh the burdens, but there are burdens.

Senator SPECTER. Do you agree with the testimony of Mr. McGrath, that Conrail at least satisfies the standards for an acquiree demonstrated able to provide long term, viable, competitive rail service?

Mr. CLAYTOR. I am not really sure I——

Senator SPECTER. Well, I questioned Mr. McGrath at some length this morning about how strong outfits like Pittsburgh and Lake Erie and Guilford were. Then we started talking about Conrail and measuring Pittsburgh and Lake Erie, for example, against this standard of the Department of Justice, of a line which would have demonstrated ability to provide long term, viable, competitive rail service. As a railroader, do you think that Conrail would satisfy that standard?

Mr. CLAYTOR. I would think that as part of our system they would satisfy that standard. I am not sure standing alone Conrail can be said to be long term viable.

Senator SPECTER. Are you sure to the contrary?

Mr. CLAYTOR. Sir?

Senator SPECTER. Are you sure it would not be?

Mr. CLAYTOR. Senator, there is nothing sure or certain in this life, but that is my opinion and that is the opinion of the studies that I have seen, that in another 7 or 8 or 9 years that a standalone Conrail is not going to survive, that you are going to have a negative cash flow, and negative cash flow is one thing a company cannot stand for very long. And if the economy does not pick up or if the smokestack industries continue to move away from the Northeast, as I hope they will not, then Conrail does have a very, very dim future alone. We are willing to take the burden of that.

Senator SPECTER. What study have you seen to that effect?

Mr. CLAYTOR. We made our own, and I think there was one made by DOT.

Senator SPECTER. Would you provide that study for us, please?

Mr. **Claytor**. I will provide the study that we made to the extent we may legally do so. We have a confidentiality agreement with Conrail which we may not violate. But other than that I will provide it.

Senator **Specter**. You say you have seen a study by the Department of Transportation?

Mr. **Claytor**. I have not seen such a study. I understand there is one.

Senator **Specter**. What is the basis of your understanding to that effect? Who told you?

Mr. **Claytor**. As I recall, Mr. Riley, the Federal Railroad Administrator, indicated that we were in the same ballpark with them.

Senator **Specter**. On the subject that Conrail is a failing railroad, or would not be viable in a period of time down the road?

Mr. **Claytor**. Yes, sir. Down the line the future of Conrail was very much in doubt.

Senator **Specter**. What factors lead to that conclusion that Conrail is—when you say very much in doubt, do you mean it is going to fail, or it is uncertain?

Mr. **Claytor**. If it fails, I suppose what I am saying is the first step is it goes back into bankruptcy.

Senator **Specter**. My question is not what happens to it. My question is: What is the factual basis that leads you to assert that Conrail cannot continue to make money down the line?

Mr. **Claytor**. It has to be forecast, Senator. First you have to forecast the economy. Then you have to forecast rail traffic. Then you have to forecast your expenses, which involve looking down the line to see how much rail and ties you are going to have to put in. Conrail's traffic trend has been going down since 1964. There are blips up and down in it, but in 1964 they had 400 million tons.

Senator **Specter**. How about since 1981?

Mr. **Claytor**. Since 1981 it went up—it came down a little bit in 1981. It turned in 1982.

Senator **Specter**. It has been doing pretty well then since 1982?

Mr. **Claytor**. It has been going back up, but they are so far below what they were that it is——

Senator **Specter**. So far below what they were in 1964, but since 1982 it is pretty good?

Mr. **Claytor**. Well, I certainly hope they continue to go up, Senator. I do not want Conrail to fail, either alone if I am wrong or as a part of Norfolk Southern in which case it would hurt us badly. I think as part of Norfolk Southern, Conrail has a substantially better chance of turning around and increasing its tonnage and being more competitive. As the only regional railroad left, Conrail has a disability which we propose to overcome by making it part—an integral part—of a larger and more profitable system.

Senator **Specter**. Thank you, Mr. Chairman. I will await my next turn.

The **Chairman**. I will come back to you.

Senator **Specter**. Thank you.

The **Chairman**. The distinguished Senator from Ohio.

Senator **Metzenbaum**. First, Mr. Chairman, on behalf of Senator Biden may I put some questions into the record for Mr. Claytor to answer.

The CHAIRMAN. Without objection.

Senator METZENBAUM. Mr. Claytor, how do you intend to raise the $1.2 billion purchase price?

Mr. CLAYTOR. I am glad you asked that question, Senator. That gives my executive vice president of finance a chance to say something. If you do not mind, I will turn the question over to Mr. John Turbyfill.

Senator METZENBAUM. I want him to earn his keep.

Mr. TURBYFILL. We are going to borrow it, Senator.

Senator METZENBAUM. And do you have those arrangements made at the moment?

Mr. TURBYFILL. On an informal basis only; yes, sir.

Senator METZENBAUM. And the interest you pay in that connection will all be a deductible factor partially subsidized then by the Treasury?

Mr. TURBYFILL. Well, if that is what deductible means we will pay interest and it will be deductible.

Senator METZENBAUM. So you will have the deduction for the interest. Would you like to comment on what I said earlier this morning about the $3 billion being available to you as a tax writeoff. And we quoted your tax lawyers as having agreed to that fact. Do you have any question about that you want to address yourself to?

Mr. TURBYFILL. Well, the $3 billion, Senator, of writeoff will be available to Conrail whether it remains the way it is, whether it is bought by someone else, whether it is sold to us, whether it is a public issue. That is just part of the tax law, and we will follow the same tax law everyone else has to follow.

Now, as far as the built-in deduction problem which you referred to, the tax lawyers advise me that we do not know whether the built-in deduction will apply to us. However, we——

Senator METZENBAUM. John Harris is your chief tax lawyer on this issue?

Mr. TURBYFILL. Yes, he is.

Senator METZENBAUM. Of Covington and Burling?

Mr. TURBYFILL. That is right.

Senator METZENBAUM. He told my staff exactly what I stated this morning.

Mr. TURBYFILL. I do not think he told your staff, sir, that we would have no problem getting within the exception of the built-in loss deduction. That is certainly not what he has advised us. But, irregardless, we do hope to get within that exception. It is questionable.

But the point is we will follow the same tax law that applies to every corporation in this country. We are asking for no special exemptions or concessions with respect to that point.

Senator METZENBAUM. But if Conrail should stop making money you would be able to use that $3 billion tax writeoff in connection with some of Norfolk Southern's earnings, too, would you not?

Mr. TURBYFILL. If we can comply with the exception; that is true.

Senator METZENBAUM. Are there other ways that that can be done besides the 85-percent figure that provides for the exception?

Mr. TURBYFILL. I am not aware of any other way.

Senator METZENBAUM. Could you move some Norfolk Southern profitable operations over into Conrail in order to be sure to use up that tax——

Mr. TURBYFILL. If Conrail can increase its income within——

Senator METZENBAUM. You could switch some things over in order to help them along.

Mr. TURBYFILL. Well, as long as we comply with the law—we intend to comply with the same Internal Revenue Code that everyone else has to follow.

Senator METZENBAUM. The point that I made earlier today was that for $1.2 billion you will be able to depreciate $3 billion of capital assets that were paid for with $7 billion of taxpayers' funds.

Mr. TURBYFILL. In fact, Senator, Conrail's basis for its assets was about $3 billion at the time it was formed in 1974. That basis has not increased in the interim. So we are getting about the same basis as any other purchaser would get that was available when Conrail was formed.

Senator METZENBAUM. Have they made any capital expenditures since that time?

Mr. TURBYFILL. Well, I am sure they have, and they have written them off just like anyone else. This was in Mr. Simons' testimony. I assume it to be correct.

Senator METZENBAUM. I think Mr. Claytor's testimony in chief covered this, but I gather that none of the $1.2 billion will come from Conrail's own cash.

Mr. CLAYTOR. No, sir.

Mr. TURBYFILL. That is true.

Senator METZENBAUM. Norfolk Southern will be able to dividend out a portion of Conrail's earnings, including part of that $800 million over a period of time; is that not correct?

Mr. TURBYFILL. Well, we can only dividend out 40 percent of its earnings and only those earnings that occur after the closing. So as a practical matter that $800 million has to remain there until Conrail generates future earnings.

Senator METZENBAUM. Are those pretax earnings or aftertax earnings?

Mr. TURBYFILL. Well, it would be after tax, I assume.

Senator METZENBAUM. Do you know, Mr. Claytor?

Mr. TURBYFILL. It is 40 percent after tax. It has to be after tax.

Mr. CLAYTOR. It would have to be after tax.

Senator METZENBAUM. Why would it have to be after tax? It does not have to be.

Mr. TURBYFILL. That is what the memorandum provides.

Senator METZENBAUM. I am just asking you. I do not know the memorandum.

Mr. CLAYTOR. The answer is, Senator, I do not remember.

Mr. TURBYFILL. It is 40 percent of net income, Senator, and net income means after tax.

Mr. CLAYTOR. Yes, that is right.

Senator METZENBAUM. Will you read me the definition in the agreement that net income means after tax. Net income does not always mean after tax.

Mr. TURBYFILL. Yes, sir, I think in generally accepted accounting principles, my understanding—I am not an accountant—but my understanding is net income means after tax.

Senator METZENBAUM. I am not arguing the point, but I just want to be certain that what you are stating is the fact. I do not know the answer.

Mr. TURBYFILL. Well, the definition—this will not necessarily answer your question—well, it will, too. Cumulative net income—that is the definition we are dealing with—for any period subsequent to the closing means net income of Conrail and its consolidated subsidiaries after provision for income taxes.

Senator METZENBAUM. What was the projected level of Conrail's earnings used in constructing your $1.2 billion bid? Do either of you know?

Mr. CLAYTOR. The answer is I do not remember, Senator. We originally, as I testified in the Commerce Committee, we originally had proposed a bid of $900 million which we felt was fairly good. And I increased that somewhat arbitrarily to $1 billion because I thought that was necessary to get a bid in, and later it was increased to $1.2 billion.

Senator METZENBAUM. Mr. Claytor, I do not know of any corporate executive who in making an acquisition does not have his people who are part of his team put together some working papers to indicate what it is anticipated that the acquisition will make in the first year, the second, third, and on down the line.

And what I am asking you, if you do not have it with you at the moment, I can understand that; but I would like to have it and I think the committee should have it as to what Norfolk Southern's own figures, what figures you used in arriving at your bid. They may be high. They may be low. But I certainly think they are important to have and I would like to have them as promptly as possible.

Mr. CLAYTOR. Again, to the extent that this does not divulge any figures which we are contractually bound not to disclose we will be glad to do that, Senator.

Senator METZENBAUM. Well, if you find that you are contractually bound not to disclose it——

Mr. CLAYTOR. We will discuss it with you.

Senator METZENBAUM [continuing]. Then if you will discuss it with us, we will perhaps get an exception to the contract.

Mr. CLAYTOR. Our style of business is to be open and candid, and we would not go into this if we had not felt we had a reasonable chance to get a reasonable return on our investment.

Senator METZENBAUM. I would not think you would. I would not respect you if you did.

Mr. CLAYTOR. I think our figures came out approximately the cost of capital.

Mr. TURBYFILL. We have done a lot of this work, Senator, as you would expect. And we expect to make a net return equal to the cost of capital, which is, we think, marginal. In other words, we have to have at least that much.

Senator METZENBAUM. If you had only that, it would not make sense for you to make the deal, would it, because Mr. Claytor said a little bit ago this deal is big enough to sink your company if it does not go through. Now, if you are only going to get back enough to cover your cost of capital, then I do not think Mr. Claytor ought to go forward and make the deal.

Mr. CLAYTOR. There may be some who would agree with you, Senator. I think I am taking some chance with this. It is not that clear.

Senator METZENBAUM. Do you have the figures, by any chance, on the projected earnings for the next 5 years?

Mr. TURBYFILL. I do not have them on me, Senator. I think, Senator, one other point that you should keep in mind is that if this were such a deal, sweet deal as you would indicate, there would be others bidding for Conrail at higher prices.

Senator METZENBAUM. Well, I have some of my own views on that. I think there was somewhat of a restricted effort to get the bidders. But that really is not your concern. I mean, you are a legitimate bidder, you are a legitimate buyer, and it is not your responsibility to go out and see that two other people or six other people come in. My time has expired, but I do have some additional questions, but I want to be fair to my colleagues.

The CHAIRMAN. The distinguished Senator from Kentucky.

Senator MCCONNELL. Thank you, Mr. Chairman.

You may have covered this, Mr. Claytor, but briefly tell me again the status of your negotiations with prospective acquirers of divested lines.

Mr. CLAYTOR. We have, as far as I know—I am not handling these personally and those who are immediately involved will testify later today, but we have an agreement in principle with the acquiring lines which we hope to finalize in the very near future.

The CHAIRMAN. Excuse me just a minute. I have to go to the markup of a bill. I am going to ask the distinguished Senator from Kentucky to preside until I get back.

Senator MCCONNELL [presiding]. Thank you, Mr. Chairman.

I have heard charges that the lines Norfolk Southern proposes to divest have a striking resemblance to is abandonment program. I wonder if you could address that charge.

Mr. CLAYTOR. To its what program, Senator?

Senator MCCONNELL. Abandonment program.

Mr. CLAYTOR. Some of the lines which we propose to divest, yes, indeed, we will probably be forced to abandon if we do not go through with this. I have already mentioned one of them which is the line east of Cleveland. That is true.

Senator MCCONNELL. What impact, in your judgment, will the acquisition have on the coal industry?

Mr. CLAYTOR. It will have a positive and good effect on the coal industry.

Senator MCCONNELL. Describe that to me.

Mr. CLAYTOR. I would be glad to. Senator, CSX is the biggest coal carrier. We are second. Maybe BN is bigger than both of us. Now they have gotten a lot more tonnage. But CSX is the big coal carrier in the East. But both of us, CSX and Norfolk Southern, pride themselves on being able to be efficient, competitive carriers who push their coal markets, who push them hard. We want to increase the production all along our lines. And we look for ways to do it, both of us, and both of us, I hope, succeed.

The idea that this could hurt the coal industry to me is inconceivable. We want to export more coal. We want to export more coal from Kentucky, from Virginia, from West Virginia, from Maryland, from Pennsylvania, if and when we can get Conrail. The only way we make money from the coal industry is to move the coal.

And we want to move coal, and we think we are pretty good at it and we work hard at merchandising it overseas. I think that both Norfolk Southern and CSX can take a back seat to no one when it comes to backing the coal industry.

Senator McConnell. Again, kind of a general question: what kind of impact on farming do you think this is going to have?

Mr. Claytor. Well, I would think the impact on farming—and you translate that into the movement of grain, which is very important, will be positive.

Senator McConnell. Yes. That is what I am talkinq about.

Mr. Claytor. For instance, we got a positive impact from the Norfolk and Western and Southern consolidation in the movement of grain. When you offer single line-system service, you are able to move grain farther at more competitive rates with your own equipment and in the case of Norfolk Southern, we were able to move grain from the Norfolk and Western area of the midwest into the South that before did not move.

And by the same token making Conrail part of a system which extends as far west into the grain belt as Iowa and Missouri there is going to give better opportunity to move grain to the consuming centers in the East and for export. The American Farm Bureau is supporting us, I am informed; maybe that was the answer to your question.

Senator McConnell. Thank you. The Senator from Illinois.

Senator Simon. Thank you, Mr. Chairman.

There are those who say they are going to be hurt in the railroad industry; one of them is ICG in Illinois, which estimate's its loss somewhere between $28 and $53 million a year. Is that a realistic assessment on their part?

Mr. Claytor. Not from our point of view. I think that is much overstated. Our assessment of the situation is different. Our assessment is a maximum diversion of about $16 million. My opinion is that the division will not be that great, because we want to work with the ICG particularly over the Effingham gateway, which they are particularly interested in. And we would be willing to see what could be worked out.

We want run-through service and we want the kinds of service which attract and hold shippers. It is inconceivable to me that we would want to dry up the Effingham gateway, which is the ICG's particular concern.

Senator Simon. Another charge that is made against this sale is that it would move the western gateway from Chicago and St. Louis to Kansas City. I guess I have two questions on that. No. 1, is that true? No. 2, what does that mean in terms of jobs and the economy of the St. Louis area and the Chicago area?

Mr. Claytor. There will be opportunities for longer hauls on some business to the Kansas City gateway. It is not conceivable to me that the great bulk of the business now moving through Chicago and St. Louis could possibly be diverted by anyone to Kansas City.

In the first place, our single track railroad could not handle it out there, and when we cannot handle something well, we do not try to because we live on good service. I do not think the consolidation will have any substantial impact on the employment levels in those locations.

Senator SIMON. Another charge or at least another concern—I do not say it is a charge—was raised by Senator Mathias earlier today and that is that this sale is going to help the Norfolk Port, but other ports in the Nation are going to be hurt. And obviously indirectly that has some impact on Illinois. I am a little bit provincial as I look at these things, Mr. Claytor.

Mr. CLAYTOR. Well, I think you should be, Senator Simon.

Senator SIMON. But what is your response? I think you were here when the question was asked.

Mr. CLAYTOR. I would be glad to try to address that. Let us take something in Chicago which is going to be exported. At the present time Norfolk Southern serves just about every port from Norfolk, Virginia on the north around to New Orleans on the Gulf port.

We work with and for every one of those ports. And each of those ports has advantages such as depth of channel; geography may be an advantage to one, facilities. We will work to move that business through any one of those ports from Norfolk around to New Orleans.

We do not work for the ports of Baltimore, Wilmington, Philadelphia, New York, and Boston because we do not reach them. We have been frozen out by rate and other action. CSX gets to Baltimore. We do not get to Baltimore. I would like very much to increase the business through Baltimore. I think it has some advantages that other ports do not have. I would like to increase the business through Philadelphia. I would like to be able to work through New York. At the present time, we will work against them. But in the case I gave of a shipment from Chicago, our salesmen go to the shipper and say, look, here are the ports that we serve. Here are the steamship sailings. Here are the advantaqes and disadvantages. They are all good ports. Where do you want us to work toward. So that it has to be a positive influence for the northern tier ports.

We are not going to favor any one port, particularly Norfolk, just because our headquarters of 150 people happen to be there. We will not do that.

Senator SIMON. And so there is not going to be—you are not going to try and squeeze out New Orleans which obviously has some advantages to many Illinois shippers.

Mr. CLAYTOR. No, sir, we could not afford to to that. We have railroads to all these ports and we have to try to be neutral, and we are.

Senator SIMON. Have you done any estimates of what the impact of this sale would be on railroad jobs in the Nation?

Mr. CLAYTOR. Yes, we have some information on that. The figure that we used first for the gross number of jobs that we felt were going to be affected by the coordination, such as putting yards together and moving traffic over from one line to the other—correct me if I am wrong about this, Mr. Watts—2,530 jobs.

This is tempered by the fact that a number of lines that were going to be abandoned are included in the diversions, lines to be sold. If you deduct the employees affected by the diversions 1,800 would be the number of employees affected by the consolidation.

Then you can offset that by the new jobs that we will have to put on for various other reasons—about 600; so we get a net figure of about 1,200 jobs.

Senator SIMON. If I can be a little more specific. Will any Norfolk Southern railroad employees lose their jobs?

Mr. CLAYTOR. The impact falls more on Norfolk Southern people than it does on Conrail.

Senator SIMON. And of that 1,200 net, roughly how many Conrail jobs, and how many Norfolk Southern jobs, are we talking about?

Mr. CLAYTOR. I am sorry, sir. I do not know. Of the initial 2,530, more were on Norfolk Southern. After you net them out, I do not know whether I made a correct statement when I said that most of them are on NS. I am sorry. I do not know.

Senator SIMON. Well, I thank you. Let me just add that Ned Brethitt has been doing a good job contacting Members of the Senate. He asked me to mention that. I told him I would. [Laughter.]

Mr. CLAYTOR. Thank you, Senator. That means a lot to Ned.

Senator SIMON. OK. Thank you, Mr. Chairman.

Senator MCCONNELL. The Senator from Pennsylvania.

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Claytor, do you know what the net liquidation value is of Conrail?

Mr. CLAYTOR. No, sir, I do not know. The answer, Senator, is, No, sir, we do not. I can give you the net liquidation value of the other lines, but not Conrail.

Senator SPECTER. Which lines do you know the net liquidation value of?

Mr. CLAYTOR. The ones we propose to divest.

Senator SPECTER. What is the net liquidation value of the lines you propose to sell?

Mr. CLAYTOR. Our preliminary estimate of this—and this is not a firm or binding figure because some of this is land which has to be separately looked at—about $110 million.

Senator SPECTER. Mr. Claytor, I wrote to Secretary of Transportation Dole on August 7, and again on September 7, 1984, asking for the value of all the assets of Conrail, such as rights-of-way, equipment, buildings, et cetera, and have not yet gotten an answer. Have you gotten an itemization of all the assets of Conrail?

Mr. CLAYTOR. I certainly have not seen any such. No, sir, I am informed that we have not, and I believe our people here would know if we had.

Senator SPECTER. Do you expect to get such an itemization?

Mr. CLAYTOR. No, sir.

Senator SPECTER. How do you know what it is that you are buying?

Mr. CLAYTOR. We are buying on the basis of hoped-for earning power.

Senator SPECTER. So you do not expect to get an itemization of all of the assets of the Conrail Corporation?

Mr. CLAYTOR. No. I would not think that would be terribly helpful to us. I would like to know the status of some of their reserves and figures like that, which are not presently available to us, and before we go through with this we will have to do a so-called "due diligence" and go over the accounts of Conrail. That is where we would look rather than an evaluation of the assets.

Senator SPECTER. I am advised that Mr. Stanley Crane has placed a figure of $3.1 billion as the net liquidation value of Conrail. Would you have any reason to think that would be inaccurate?

Mr. CLAYTOR. I would have no reason to think it is accurate or inaccurate. In all fairness, I just do not know.

Senator SPECTER. There have not yet been formal divestiture agreements between Norfolk Southern and Guilford or Norfolk Southern and P&LE?

Mr. CLAYTOR. No final agreement has been signed. I am hopeful there will be very shortly.

Senator SPECTER. Is it in draft form at the present time?

Mr. CLAYTOR. I have not seen a draft agreement, yet. Is there one made?

Mr. WATTS. Yes, sir.

Mr. CLAYTOR. I am informed that there is such an agreement in draft form which I have not been over.

Senator SPECTER. Under the procedures, will the U.S. Government be a party to those agreements?

Mr. CLAYTOR. A formal party? May I consult my attorney?

Senator SPECTER. You have a right to do that.

Mr. CLAYTOR. He is in charge of it. He says no, Senator. It has to be reviewed by Justice, as we have described this morning, but I understand that the United States does not have to be a formal party to it.

Senator SPECTER. Will those agreements be made public after they are signed?

Mr. CLAYTOR. I am sure they will be.

Senator SPECTER. Will you supply copies to this committee after they are signed?

Mr. CLAYTOR. Yes, sir.

Senator SPECTER. The rehabilitation and maintenance costs on lines proposed for divestiture are estimated, according to information provided to me, to be in the range of $200 million. Is that an accurate figure, as far as you know?

Mr. CLAYTOR. I have no way of knowing, Senator. It sounds high to me. I might just add, I think we have 1,320 miles to divest; is that correct?

Mr. WATTS. That is right.

Mr. CLAYTOR. Of that, 630 miles is presently maintained for 60-mile-an-hour service, which is as fast as we run any train anywhere on our railroad; 500 miles are maintined for 40-mile-an-hour service, and only 190 miles are for 25. But I have not any specific information other than that.

Senator SPECTER. Would you have any idea as to what it will cost for rehabilitation of those lines?

Mr. CLAYTOR. I do not, and I do not think that it will be necessary to make any major rehabilitation of a good portion of them. For instance, I have ridden many times over the line we have from Cleveland to Buffalo, and while we only run 60 on it, that is as good a piece of railroad as there is any place in the world.

Senator SPECTER. Is Norfolk Southern continuing to negotiate with Grand Trunk for acquisition of some of these lines?

Mr. CLAYTOR. I understand we received a letter from them yesterday making some proposition or suggesting something, but the answer is no.

Senator SPECTER. So that the only possible purchasers of lines to be divested are Pittsburgh and Lake Erie and Guilford?

Mr. CLAYTOR. As far as I know, that is so.

Senator SPECTER. Mr. Claytor, going back to your statement that you made before the Commerce Committee—an item that I referred to in the questioning of Mr. McGrath—you said: "Selling lines to other carriers diverts to competitors over $100 million a year in traffic off the combined Norfolk Southern/Conrail system." Is that the maximum amount that will be diverted to the competitors that you will be divesting to?

Mr. CLAYTOR. That is our best estimate of what will be diverted. It might be more.

Senator SPECTER. What commitments are you in a position to make, Mr. Claytor, say, as to the retention of the 15,000 employees who work in Pennsylvania?

Mr. CLAYTOR. We have detailed this at some length, Senator Specter. We feel that our proposition is good for the loyal Conrail employees in Pennsylvania because jobs follow the freight. And we want to get more business. But to answer your question more specifically, we have outlined what we will do for any jobs which are affected by the consolidation and we have gone further and offered protection of 1 year's pay against any added efficiencies for a 3-year period.

Today, Conrail would not have to do that. But we are willing to be obligated to do that because we want the loyalty and we want the support of the Pennsylvania employees of Conrail. It is necessary if we are going to make a success of this.

We cannot be successful unless we have a team, and that is what we want to put together.

Senator SPECTER. My question was, What commitments have you made to Pennsylvania's 15,000 employees of Conrail?

Mr. CLAYTOR. The same commitments that we have made to all of the other employees of Norfolk Southern and Conrail in connection with the consolidation as far as job protection, New York dock, and our agreement to pay $375 million for Conrail employees' interest in the ESOP, which amounts to somewhere between $9,000 and $11,000 per employee as well as the job protection which I have outlined.

Senator SPECTER. Well, I do not understand your answer. Let me ask the question one more time. Aside from what you have done for others, what commitments have you made to Pennsylvania's 15,000 employees? Are you saying that each one of those employees has assurance for 3 years, or are you not saying that?

Mr. CLAYTOR. I am saying that any one of the 15,000 Conrail employees whose job is adversely affected within the 3-year window would get 1 year's pay. This is in addition to the 6 years' protection which is provided for anyone whose job is directly affected by the consolidation; this is the New York dock protection.

Senator SPECTER. Well, would each employee be protected for 6 years under what you have just said?

Mr. CLAYTOR. Up to a maximum of 6 years, depending on the length of his employment; if it was over 6 years, he would get the 6 years.

Senator SPECTER. Everyone who has been employed for 6 years is guaranteed a job for 6 additional years?

Mr. CLAYTOR. No. Anyone whose job is adversely affected by the consolidation would get a 6-year protection.

Senator SPECTER. Suppose somebody is laid off, how do you define "adversely affected by the merger"?

Mr. CLAYTOR. I am not sure I can do that. That is a very technical thing. I will say this, if someone were laid off on Conrail or Norfolk Southern in the next 4 or 5 years because business turned down and there was not any job for them, there would be no protection any more than there is today.

We are not proposing an attrition agreement or a job freeze because that is exactly what got Penn Central into bankruptcy.

Senator SPECTER. Well, all I am trying to do is to understand what the assurances are. I will wait my turn again, Mr. Chairman.

Senator McCONNELL. The Senator from Ohio.

Senator METZENBAUM. Mr. Claytor, or perhaps the financial man——

Mr. CLAYTOR. That is OK with me, Senator.

Senator METZENBAUM. Either one. What is your name, sir?

Mr. TURBYFILL. Turbyfill.

Senator METZENBAUM. Is there any value to you in the fact that Conrail's defined benefit plan has a $250 surplus?

Mr. TURBYFILL. Sir, we do not have adequate information to know whether or not it has a $250 surplus. To the extent it has a surplus I suspect it is on the basis that the plan would be terminated, which we would not be permitted to do.

Conrail has been making contributions to that plan over the last several years and that would lead us to believe that it is not overfunded; otherwise they would not be making contributions.

Senator METZENBAUM. Conrail's annual report does say that it is $250 million overfunded.

Mr. TURBYFILL. Well, Conrail's annual report gives the assets and the present value of those assets; it does not purport to say that it is overfunded on a continuing basis. And Conrail's plan——

Senator METZENBAUM. Conrail's representations to us confirm that which I have stated to you, and that is that they agree that it is overfunded.

Mr. TURBYFILL. Let me say, Senator, we do not know. We have not had access to that information.

Senator METZENBAUM. Are you saying that because the value of its assets has grown that you do not consider that to be overfunded?

Mr. Turbyfill. No. What I am saying, Senator, most pension plans including our own, if we were to terminate our pension plan today, we would be overfunded. Our plan would be and Conrail's probably would also be overfunded. But if you are obligated to continue to fund benefits into the future, most plans are not overfunded. What I am saying is I assume this is not because they are continuing to make contributions.

Senator Metzenbaum. You know that there are many funds in recent years that have been terminated.

Mr. Turbyfill. That is true.

Senator Metzenbaum. And in fact some companies have made purchases of companies—a German company bought A&P and picked up in the overfunding more than the cost that they paid for the whole company. And Occidental did the same with Cities Service. They terminated the fund and what happened is—you say you would not be permitted to terminate—but the fact is they terminate and they work it out with annuities.

Mr. Turbyfill. I understand that, Senator, and I am sure that is the reason for the provision in the memorandum of intent that prohibits us from terminating the Conrail plan.

Senator Metzenbaum. But that memorandum also would make it possible for you to merge the Conrail plan and the Norfolk-Southern plan and it does not provide any prohibition with respect to termination of the Norfolk-Southern plan.

Mr. Turbyfill. Well, that is true, Senator, but I can assure you the last thing in the world we are going to do is terminate either of those two plans.

Mr. Claytor. I am going to retire next year, Senator. I am not going to let them terminate it.

Senator Metzenbaum. I had a senior vice president up here for a hearing one day and he retired and be was complaining about the fact that they had terminated the plan and how he was left high and dry. So beware, Mr. Claytor.

Mr. Claytor. I will, sir. We have been in this game a long time, as you know, Senator, 100 years, maybe, and we have not terminated them during that 100 years, the plan we have had, and I do not think we will in the next 100.

Senator Metzenbaum. What if Congress or the DOT were to provide in some manner that you could not use Conrail's writeoffs to offset Norfolk-Southern income, would that bother you?

Mr. Claytor. I am not the expert on this, but as I understand it, that would be some change in our understanding of what we bargained for, that we had a right to get whatever tax benefits any other taxpayer would get under similar circumstances, and that would be a change.

Senator Metzenbaum. So that you would object to that?

Mr. Claytor. I would object.

Senator Metzenbaum. Because you recognize that it does indeed have a value to be able to depreciate——

Mr. Claytor. It has a possible value. The lawyers will not tell me whether or not they think they could win the argument with the IRS, but I sure hate to give up any argument with the IRS. I need them all.

Senator **METZENBAUM**. Particularly if you can pick up $1.8 billion over and above the $1.2 billion you have in it.

Mr. **CLAYTOR**. I am not sure we could ever do that, but I think we ought to have the same tax benefits any other taxpayer would get under similar circumstances.

Senator **METZENBAUM**. The overriding factor in the Secretary of Transportation's decision to sell Conrail to Norfolk-Southern was Norfolk-Southern's position as a strong company with deep pockets. Now, currently Norfolk-Southern has one of the lowest debt to equity ratios in the rail industry by 19 percent. We have already been told that you will borrow $1.2 billion to buy Conrail. If that debt is reflected in a consolidated financial statement, your debt to equity ratio could jump to 66 percent. Would you comment on that as to how it would affect Norfolk-Southern's position as a so-called deep pockets company.

Mr. **TURBYFILL**. I do not know where the 66 percent comes from, Senator. Our calculations are that it would rise to about 40 percent, perhaps a little less.

Senator **METZENBAUM**. I do not have the figures before me.

Mr. **TURBYFILL**. I assume we would be glad to show you the calculation, but our calculation is in the high thirties.

Senator **METZENBAUM**. I am told that the source of that was not the brilliant staff that I have but Conrail itself.

Mr. **CLAYTOR**. That explains it, Senator. That explains it. [Laughter.]

Senator **METZENBAUM**. Presently Norfolk Southern cooperates with the Grand Trunk Railroad to move shipments to and from Detroit. This merger would give Norfolk Southern direct access to Detroit over Conrail's lines. After the merger why would Norfolk Southern not divert all of GTW's traffic to Norfolk Southern leaving GTW with only short haul routes in Michigan?

Mr. **CLAYTOR**. The same reason that we are not able to do it today. We go to Detroit today with Norfolk and Western Railway, Senator. And Grand Trunk does very well indeed in that market because they offer a service and they have good relations with the shippers. This is one of the railroads that we said we would keep routes open with that had been hurt by Conrail.

We have reopened selected routes, and I think Grand Trunk stands to gain from this. I am sure they do.

Senator **METZENBAUM**. Well, Grand Trunk, I did not talk with them directly, but from what I understand they have indicated that they are very much concerned that they might be very much squeezed short of driving them out of business.

I cannot tell you who said what when, but I am not sure that they are as enthusiastic as you would make it out.

Mr. **CLAYTOR**. I would agree with you that they are not enthusiastic, Senator, but I disagree that they would be hurt.

Senator **METZENBAUM**. All right. Do you think you know better than they do as to whether they would be hurt?

Mr. **CLAYTOR**. Yes, sir, I do.

Senator **METZENBAUM**. How does the quality of the divested line to St. Louis compare to the Conrail line to St. Louis which you will retain?

Mr. Claytor. The quality of the line, that is a line that we are selling to St. Louis; it is the old Nickel Plate Clover Leaf District line. We do not have any through service over that line. It is a secondary line. It is not in the same quality as the line I referred to from Cleveland to Buffalo.

The rail is good because there has been very little business over it. It has not worn out. It needs ties. It would require some ties to upgrade it to a higher speed.

Senator Metzenbaum. When do you anticipate retiring, Mr. Claytor?

Mr. Claytor. Senator, I am required under our retirement plan to retire at the end of February 1987. But the Congress in its wisdom has passed some new tax laws which require me for my own welfare to retire no later than December 31, 1986 provided the board has not retired me sooner.

Senator Metzenbaum. Then perhaps you can feel very free to answer this question with 100 percent candor because you do not have to worry about your job into the future, and I want you to think about the question.

Senator McConnell. The Senator's time is up.

Senator Metzenbaum. I know, but I am going to finish this last question first, Senator, please.

If you had the final decision and you represented the Government—you are on the opposite side of the table, honestly—would you make this deal for $1.2 billion and do all the other things that the Government is doing or would you not have some reservations as to whether it ought to be sold?

Mr. Claytor. I can answer that honestly. Senator, the $1.2 billion, of course, is the 85-percent interest. So that is not the total cost of Conrail. But shorthand says it is. In my opinion—and I will try to be honest with you—yes, I would make the deal because I think that Conrail basically has peaked and this is the time to sell it if I were the seller. And I think waiting is only going to result in a lower price for Conrail, and if you wait long enough you are not going to get anything for it.

Senator Metzenbaum. I appreciate your answer. I do not know that you have persuaded me, but I appreciate the fact that that is exactly the way you feel. Thank you, Mr. Chairman.

Senator McConnell. We have had a number of witnesses that have been waiting patiently for some time. I know Senator has a couple more.

Senator Simon. I do not have any further questions.

Senator McConnell. Thank you, Senator Simon. The Senator from Pennsylvania.

Senator Specter. Just a couple more questions, Mr. Claytor.

What commitments, if any, is Norfolk Southern in a position to give to the retention of the corporate headquarters in Philadelphia?

Mr. Claytor. We have a covenant in the agreement, in the Memorandum of Intent that we would maintain the headquarters the same length of time as the others, which is 5 years. I have already indicated to you that for economic and practical reasons I do not see any chance that we would in the foreseeable future ever think about moving the headquarters of Conrail. It is to our advantage to keep it in Philadelphia. It is a sound economic decision.

Senator SPECTER. Did not Marriott state a willingness to make a commitment to keep the corporate headquarters in Philadelphia for 10 years?

Mr. CLAYTOR. I do not know, sir.

Senator SPECTER. What commitments, if any, were made about the retention of the repair yards at Hollidaysburg, PA?

Mr. CLAYTOR. There is a convenant concerning the Altoona shops and the Hollidaysburg car shops. Altoona is one of the jewels in Conrails' crown. I have been through those shops. I wish they were on Norfolk Southern. I look forward to having them on Norfolk Southern. They are the best locomotive shops in the industry, in my opinion, and the people out there are very good and very dedicated. And I see the opportunity for more work for those locomotive shops.

Senator SPECTER. Let me see: My question was what commitments were made to that yard?

Mr. CLAYTOR. The same window, a 5-year window in the agreement.

Senator SPECTER. To maintain them in their current workload generally for 5 years?

Mr. CLAYTOR. I am not sure of the—I do not think there is any specific reference to employment in the covenent. I do not remember. "Maintain its locomotive shop and car repair facilities at Altoona, Pennsylvania." That is the way the covenant reads.

Senator SPECTER. That could be at any level at all just based on that language.

Mr. CLAYTOR. Based on that language, that is so. I would hope and believe that Altoona could be used more tban it is used.

Senator SPECTER. But there is no real commitment in that document as to Altoona?

Mr. CLAYTOR. There is not any reference to employment partly because that is an impossible thing to commit to in view of the changing workloads which are directly related to volume of business, and no one can really predict that.

Senator SPECTER. Is there any commitment as to Hollidaysburg?

Mr. CLAYTOR. It refers to car repair facilities at Altoona. I would be willing to agree that Hollidaysburg car shop is included in that.

Senator SPECTER. You would be willing to agree that Hollidaysburg has the same lack of commitment that Altoona does?

Mr. CLAYTOR. You are being real mean to me, Senator. No.

Senator SPECTER. Not yet. [Laughter.]

Mr. CLAYTOR. Gosh, I do not want to be around much longer.

Senator SPECTER. I understand what you are saying. I do not view that as any commitment, but that is a legal interpretation. How about as to Conway?

Mr. CLAYTOR. Conway is a major yard.

Senator SPECTER. My question is: Is there any commitment by Norfolk Southern—

Mr. CLAYTOR. No specific reference to any yard on either Norfolk Southern or Conrail.

Senator SPECTER. Is there any commitment to maintain any volume of flow to the Port of Philadelphia?

Mr **Claytor**. No, sir, and I do not know how anyone can do that to any port anywhere.

Senator **Specter**. One final question—the one I asked about coal. I have been advised that from western Pennsylvania, Norfolk charges $4 to $5 more a ton for the shipment of coal than does Conrail. Does that sound about right to you?

Mr. **Claytor**. From western Pennsylvania?

Senator **Specter**. Western Pennsylvania.

Mr. **Claytor**. We do not serve any coal mines in western Pennsylvania, Senator. I wish we did. We used to, and they all closed.

Senator **Specter**. You serve no coal mines at all in western Pennsylvania. How about on a comparable run, say, from Johnstown, PA, Clearfield, PA, to the Port of Philadelphia—would it be more expensive for that length of shipping to ship on Norfolk Southern contrasted with Conrail?

Mr. **Claytor**. No, sir. It would be 400 miles further. Philadelphia is the logical port for the Pennsylvania coal fields, and we would have to push. Conrail only got, I think it was a couple of million tons through Philadelphia at pier 124. We put through that much coal in less than a month in Norfolk from our fields. And I would like to see Pennsylvania have 20 or 25 million tons, too, put through the Port of Philadelphia. Nothing could be better for Conrail, and if we get them, nothing could be better for us. And we will work hard to do it. That is my pledge.

Senator **Specter**. Thank you very much, Mr. Claytor. Thank you, Mr. Chairman.

Senator **McConnell**. Thank you very much gentlemen.

[The following response was subsequently supplied for the record:]

April 18, 1985

The Honorable Strom Thurmond
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Senator Thurmond:

This refers to your letter of April 4, 1985, enclosing a series of questions concerning the antitrust implications of the sale of Conrail to Norfolk Southern.

Enclosed are Norfolk Southern's answers which we hope are responsive to your request and to inquiries raised at the March 27, 1985, hearing from members of the Committee. We welcome this opportunity to clarify Norfolk Southern's position on issues of interest to you and other members of the Judiciary Committee.

Sincerely,

Robert B. Claytor
by E.T. Breathitt
Vice President

Robert B. Claytor

Original in Mail

Enclosures

NORFOLK SOUTHERN CORPORATION'S ANSWERS TO QUESTIONS FROM THE SENATE COMMITTEE ON THE JUDICIARY

1. Please provide the Committee with the following documents normally required during railroad mergers or with comparable material developed to indicate how the merged Conrail/Norfolk Southern will be operated and what its impact on labor and current railroad traffic patterns will be:

   A. Executive summary

   B. Operating plan

   C. Traffic studies

   D. Norfolk Southern's three-year pro forma balance sheet with source and application of funds statement

   E. Labor impact analysis

During its study of Conrail, Norfolk Southern did not prepare documents in the form usually submitted to the Interstate Commerce Commission in rail merger proceedings nor did Norfolk Southern prepare comparable documents for public use. The attached documents, used in Norfolk Southern's internal analyses of Conrail, contain information responsive to the areas of interest to the Committee, including inquiries at the March 27, 1985, hearing from members of the Committee.

Executive Summary -- The attached summary was originally prepared in May 1984 for submission to Norfolk Southern's management. It has been revised to delete confidential and proprietary data and updated to reflect more recent studies.

Operating Plan -- The lists and tables reflect the operating changes proposed as a result of coordination of the operations of Norfolk Southern system carriers and Conrail. Also included are lists of Norfolk Southern and Conrail properties involved in proposed divestitures to Guilford and P&LE and of lines of Norfolk Southern system carriers and Conrail which will be the subject of abandonment applications as a result of the consolidation.

Traffic Study -- A summary of the methodology of Norfolk Southern's traffic study and a table showing estimated revenue diversions from other rail carriers are attached.

Financial Statements -- Norfolk Southern did not prepare a pro forma balance sheet or a source and application of funds statement in the form required by the ICC. In arriving at a cash offering price for Conrail, Norfolk Southern considered principally the anticipated combined earning power of Norfolk Southern and Conrail. The estimated internal rate of return from this acquisition is 15% after taxes.

As part of its study, Norfolk Southern looked at Conrail on a stand-alone basis. In response to inquiries from members of the Committee at the March 27 hearing, the results of Norfolk Southern's study of stand-alone Conrail for 1986-1993 are attached to the Executive Summary. A member also inquired about the change in Norfolk Southern's debt to equity ratio as a result of purchase of Conrail. The ratio commonly used in the financial industry is the ratio of debt excluding current maturities to total capitalization, also known as the debt ratio. Norfolk Southern's debt ratio at the end of 1984 was 16.0 percent and the anticipated debt ratio of a consolidated Norfolk Southern/Conrail will be 38.4 percent.

Labor Impacts -- Norfolk Southern originally projected that a savings of 2,530 positions would be realized as a result of the Norfolk Southern/Conrail combination. Divestitures to Guilford and P&LE will reduce the number of surplus positions significantly to approximately 1,800. The annual attrition rate on Norfolk Southern and Conrail is more than three times the projected job losses.

May 18, 1984;
revised April 16, 1985

EXECUTIVE SUMMARY

Conrail is a vastly different railroad today from the one that was formed from the bankruptcies of five northeastern railroads on April 1, 1976. Its plant has been upgraded but greatly reduced in size. Congressional action has given Conrail's management the opportunity to make major labor savings, and the opportunity has been vigorously pursued. (Employment has been reduced by 50%.)

Legislation was also enacted to relieve Conrail of passenger and commuter service burdens. Other special legislation has given Conrail the opportunity to abandon branch line operations without following the ICC procedures required of other railroads. (Route miles have been reduced by more than 25%.)

Conrail marketing efforts have been vigorous and have made full use of Staggers Act provisions to close competing routes and to surcharge or demarket noncompensatory freight business.

Operating losses ($412 million in 1977) have been replaced by net income ($313 million in 1983). Cash flow has turned positive, and Conrail currently (1983) has a cash balance in excess of $500 million.

NS is larger than Conrail by most measures (1983):

	NS	Conrail
Route Miles	17,972	14,200
Rev. ton-mi. (billions)	86.2	64.6
Employees	37,730	39,820
Oper. Revenues (millions)	$3,148	$3,025
Net Income (millions)	$356	$313

Conrail is a merchandise traffic railroad with only 19.5% of its freight revenue from coal, coke and iron ore, compared to 36.5% on NS. Since 1977 Conrail's traffic has kept up with the merchandise traffic levels on NW, but both of them have lagged well behind the Industrial Production Index.

Detailed studies to 1993 were prepared for Conrail alone, based on three traffic forecasts--probable, low, and high. The original Conrail study was based on continued government ownership and present management. The attached study covering the period 1986-1993 was updated to reflect current traffic estimates, resumption of industry wage levels and payment of state taxes, and return of Conrail to private ownership. Estimates of inflation factors and anticipated efficiency improvements are included. Conrail's capital expenditures for track were raised to a standard level, but equipment expenditures, even in 1993, still reflect the existence of surpluses in almost all categories.

For the effect of a combined NS-Conrail system, a detailed study of the potential NS-Conrail merger benefits was made. The traffic diversion study for the merger predicted gross revenue gains of $234 million per year. Costs were deducted to arrive at pretax gains.

Before divestitures were proposed, abandonments were estimated to affect 1,380 route miles, most of which are located on NS rather than Conrail. Only 1,250 miles would have lost service. With the divestitures total proposed abandonments on NS and Conrail was reduced to 460 route miles. Annual operating expense savings originally amounted to $140 million and affected 2,530 positions. After divestitures affected positions will be reduced to approximately 1,800. Capital expenditure savings totaled $337 million over the 10-year period ending in 1993.

Offsetting these benefits are capital expenditures of $51 million to achieve the consolidation and $350 million for labor protection costs. These costs, along with the benefits described above, were consolidated to reflect the full effect of Conrail's performance as part of the NS system.

NS Financial Model - V. 1.07 Conrail privatization plan ($ millions) 06-Mar-85

INCOME STATEMENT	1986	1987	1988	1989	1990	1991	1992	1993
Total revenues	3,585.0	3,812.0	4,108.0	4,055.0	4,169.0	4,616.0	5,111.0	5,461.0
Railway operating expenses:								
Way & Structures	506.4	543.6	587.9	596.7	623.4	688.0	758.4	807.2
Equipment	832.2	889.0	954.6	963.1	997.2	1,093.6	1,198.1	1,272.5
Transportation	1,480.0	1,579.0	1,720.0	1,758.0	1,814.0	2,032.0	2,245.0	2,402.0
General & admin	339.0	362.0	388.0	396.0	410.0	449.0	490.0	524.0
Total railway operating expenses	3,157.6	3,373.6	3,650.5	3,713.8	3,844.6	4,262.6	4,691.5	5,005.7
Net railway operating revenue	427.4	438.4	457.5	341.2	324.4	353.4	419.5	455.3
Other income - net:								
Interest	48.7	51.5	51.7	43.7	23.9	(2.4)	(31.6)	(63.2)
Non-rail subsidiaries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other - net	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
Total other income	88.7	91.5	91.7	83.7	63.9	37.6	8.4	(23.2)
Interest expense	89.7	94.1	100.6	107.1	112.3	116.7	120.0	124.2
Income before income taxes	426.4	435.8	448.6	317.8	276.0	274.3	307.9	307.9
Provision for income tax								
Current - Federal	6.1	1.4	0.0	0.0	0.0	0.0	0.0	0.0
State	5.6	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Deferred	167.8	177.6	206.8	222.9	242.2	147.8	136.5	132.6
Total income tax	179.5	180.3	206.8	222.9	242.2	147.8	136.5	132.6
Net income	246.9	255.5	241.8	94.9	33.8	126.5	171.4	175.3
Earnings per share	$8.39	$8.69	$8.22	$3.23	$1.15	$4.30	$5.83	$5.96

NS Financial Model - V. 1.07 Conrail privatization plan ($ millions) 06-Mar-85

BALANCE SHEET

	1986	1987	1988	1989	1990	1991	1992	1993
ASSETS								
Current Assets:								
Cash & Securities	565.6	578.1	570.5	400.3	131.5	(184.5)	(518.2)	(885.6)
Accounts Receivable	528.4	561.9	605.5	597.7	614.5	680.4	753.3	804.9
Materials & Supplies	172.8	186.6	202.7	204.1	212.1	235.7	261.3	278.4
Other Current Assets	13.8	13.8	13.8	13.8	13.8	13.8	13.8	13.8
Total Current Assets	1,280.6	1,340.5	1,392.4	1,215.9	971.9	745.3	510.2	211.5
Investments	107.3	107.3	107.3	107.3	107.3	107.3	107.3	107.3
Consol. Non-rail Sub. Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Properties, less depreciation	5,053.6	5,404.0	5,795.5	6,215.7	6,679.1	7,163.5	7,687.0	8,276.3
Other Assets	26.8	26.8	26.8	26.8	26.8	26.8	26.8	26.8
Total Assets	6,468.3	6,878.6	7,322.0	7,565.7	7,785.1	8,042.9	8,331.3	8,621.9
LIABILITIES AND STOCKHOLDERS' EQUITY								
Current Liabilities:								
Accounts Payable	609.0	652.9	709.0	720.5	745.7	830.6	917.6	980.2
Consol. Non-rail Sub. Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income and Other Taxes	(.0)	(.0)	(.0)	(.0)	(.0)	(.0)	(.0)	(.0)
Other Current Liabilities	245.6	245.6	245.6	245.6	245.6	245.6	245.6	245.6
Current Mat. of L-T Debt	120.1	132.7	157.1	174.3	184.9	195.0	198.4	211.3
Total Current Liabilities	974.7	1,031.2	1,111.7	1,140.4	1,176.2	1,271.2	1,361.6	1,437.1
Long Term Debt	886.0	932.3	972.2	994.9	1,028.0	1,042.0	1,057.6	1,090.3
Other Liabilities	82.8	82.8	82.8	82.8	82.8	82.8	82.8	82.8
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred Income Taxes	303.0	480.6	687.4	910.3	1,152.5	1,300.3	1,436.8	1,569.4
Total Liabilities	2,246.6	2,526.9	2,854.1	3,128.4	3,439.5	3,696.3	3,938.8	4,179.6
Common Stock	86.7	86.7	86.7	86.7	86.7	86.7	86.7	86.7
Additional Paid-in Capital	3,904.8	3,904.8	3,904.8	3,904.8	3,904.8	3,904.8	3,904.8	3,904.8
Retained Income	230.2	360.2	476.4	445.8	354.1	355.1	401.0	450.8
Less: Treasury Stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Stockholders' Equity	4,221.7	4,351.7	4,467.9	4,437.3	4,345.6	4,346.6	4,392.5	4,442.3
Total Liab. & Stockholders' Equity	6,468.3	6,878.6	7,322.0	7,565.7	7,785.1	8,042.9	8,331.3	8,621.9

NS Financial Model - V. 1.07 Conrail privatization plan ($ millions) 06-Mar-85

STATEMENT OF CHANGES IN FINANCIAL POSITION	1986	1987	1988	1989	1990	1991	1992	1993
CASH FROM OPERATIONS								
Net Income	246.9	255.5	241.8	94.9	33.8	126.5	171.4	175.3
Non-Cash Charges:								
Total ICC Depreciation	238.6	244.6	252.5	260.8	270.6	281.6	293.5	307.7
Consol. Non-rail Sub. Depr. & Goodwill Amort.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Income Tax Accruals	179.5	180.3	206.8	222.9	242.2	147.8	136.5	132.6
Cash from Operations	665.0	680.4	701.1	578.6	546.6	555.9	601.4	615.6
OTHER SOURCES OF CASH								
Change in Accounts Payable	23.4	43.8	56.1	11.5	25.2	84.9	87.0	62.6
Property Sales, net	52.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
Increase in Consol. Non-rail Sub. Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Other Current Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Other Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Sources of Cash	740.4	764.2	797.2	630.1	611.9	680.8	728.4	718.2
OTHER USES OF CASH								
Change in Accounts Receivable	19.6	33.5	43.6	(7.8)	16.8	65.9	73.0	51.6
Change in Materials & Supplies	5.2	13.8	16.0	1.4	8.0	23.6	25.6	17.1
Federal Income Tax Paid	6.1	1.4	0.0	0.0	0.0	0.0	0.0	0.0
State Income Tax Paid	5.6	1.3	0.0	0.0	0.0	0.0	0.0	0.0
Capital Expenditures	522.0	612.0	660.0	695.0	747.0	778.0	828.0	907.0
Change in Investments & Other Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Changes in Consol. Non-rail Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	125.5	125.5	125.5	125.5	125.5	125.5	125.5	125.5
Cost to Remove Track Material	22.0	23.0	24.0	26.0	27.0	28.0	29.0	30.0
Change in Other Current Assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash Before Financing	34.3	(46.3)	(72.0)	(210.1)	(312.5)	(340.1)	(352.7)	(413.0)
FINANCING								
Debt Principal Payments	(121.0)	(120.1)	(132.7)	(157.1)	(174.3)	(184.9)	(195.0)	(198.4)
Reacquisition of Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
New Debt Issued	135.0	179.0	197.0	197.0	218.0	209.0	214.0	244.0
Sale of Common Stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sale of Treasury Stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash from Financing	14.0	58.9	64.3	39.9	43.7	24.1	19.0	45.6
Increase in Cash & Securities	48.3	12.6	(7.7)	(170.2)	(268.8)	(316.0)	(333.7)	(367.4)
Cash - Ending Balance	565.6	578.1	570.5	400.3	131.5	(184.5)	(518.2)	(885.6)

PROPOSED PRINCIPAL NS/CR MAIN LINE ROUTES

1. North Jersey/Philadelphia/Baltimore-Harrisburg-Pittsburgh-Cleveland-Elkhart-Chicago

   Pittsburgh-Conway-Cleveland-Elkhart-Chicago - (CR) via Alliance

2. Boston/New York/North Jersey-Selkirk-Buffalo-Cleveland-Chicago

   Entire route CR

3. Detroit/Toledo-Chicago

   Detroit/Toledo-Chicago-CR via Elkhart

   Entire Route CR

4. Cleveland/Buffalo/Pittsburgh (and East)-St. Louis

   Cleveland/Buffalo and East - to Avon (Indianapolis) CR via Galion-Marion-Bellefontaine-Muncie
   Pittsburgh and East-to Alliance-Crestline-Indianapolis-St. Louis CR

5. Cleveland/Buffalo/Pittsburgh (and East)-Kansas City

   Buffalo-Cleveland-CR
   Pittsburgh-Cleveland-CR via Alliance
   Cleveland-Vermilion CR
   Vermilion-Ft. Wayne-Decatur-Moberly-Kansas City via Bellevue NS

6. Detroit/Toledo-St. Louis/Kansas City

   Detroit-Toledo CR via Air Line Junction
   Toledo-Butler CR
   Butler-Ft. Wayne-Muncie NS
   Muncie-Indianapolis-St. Louis CR
   Butler-Ft. Wayne-Decatur-Moberly-Kansas City NS

7. Cincinnati/Portsmouth (and East)-St. Louis

Cincinnati/Portsmouth and East - to Muncie via New Castle NS
Muncie-Indianapolis-St. Louis CR

8. Cincinnati/Columbus/Portsmouth (and East)-Kansas City

Cincinnati/Portsmouth and East to Muncie via New Castle NS
Muncie-Indianapolis-St. Louis CR
St. Louis-Moberly-Kansas City NS
Columbus-Ridgeway-Muncie-Indianapolis-St. Louis CR

9. Chicago-St. Louis/Kansas City

Chicago-Decatur-Moberly-Kansas City-NS

10. Portsmouth, Ohio (and NS Points East of Portsmouth)-Chicago

Portsmouth and East to Columbus NS
Columbus-N. Findlay-CR
N. Findlay-Ft. Wayne-Claypool-NS
Claypool-Elkhart-Chicago via Goshen CR
(Run through trains by passing Elkhart) Ft. Wayne-Chicago NS

11. Cincinnati (and South)- Chicago

Cincinnati-Muncie-Ft. Wayne-Claypool via New Castle NS
Claypool-Elkhart-Chicago via Goshen CR
(Run through trains by passing Elkhart)
Ft. Wayne-Claypool-Chicago NS

12. Cincinnati-Detroit/Toledo, Pittsburgh, Buffalo

Cincinnati-Dayton-Springfield-Bellefontaine-Ridgeway-Dunkirk-Toledo-Detroit CR
Cincinnati-Pittsburgh via
Dayton-Springfield-Bellefontaine-Crestline-Alliance-Conway CR
Cincinnati-Buffalo via
Dayton-Springfield-Bellefontaine-Crestline-Cleveland CR

March 29, 1985

NS/CR COMMON POINTS

Chicago, IL
Danville, IL
St. Louis, MO
Louisville, KY
Cincinnati, OH
Muncie, IN
Indianapolis, IN
Logansport, IN
Kokomo, IN
Ft. Wayne, IN
Marion, IN
Lima, OH
Toledo, OH
Detroit, MI
Oak Harbor, OH
Huron, OH
Lorain, OH
Cleveland, OH
Bedford, OH
Akron, OH
Canton, OH
Steubenville, OH
Pittsburgh, PA
Connellsville, PA
Columbus, OH
Marion, OH
Ashtabula, OH
Erie, PA
Buffalo, NY
Washington, D.C.
Hagerstown, MD

March 29, 1985

MAJOR NS/CR TERMINAL COORDINATIONS

Chicago

Blue Island Yard (IHB) - principal Chicago classification yard for non-intermodal merchandise traffic

Landers (NS) and Park Manor (CR) - intermodal

Calumet (NS) - Support

Elkhart, IN (CR) - classification yard for Chicago gateway traffic

[Colehour (CR) - convey]

Detroit/Toledo

Junction Yard (CR) - primary Detroit yard

North Yard (CR) - continue to originate/terminate road trains

Oakwood (NS) - Support

Rouge (CR) - Support

Stanley (CR) - primary Toledo yard

Homestead (NS) - Support

St. Louis/E. St. Louis

Avon (Indianapolis) (CR) - principal classification yard for St. Louis gateway traffic

Rose Lake (CR) - primary intermodal

Coordinate NS Luther intermodal into Rose Lake
Luther - retain

[Madison - convey]

Cleveland

Collinwood (CR) - primary Cleveland terminal yard

Rockport (CR) - primary Cleveland terminal yard

E. 55th Street (NS) - [convey]

Campbell Road (NS) - [convey] - retain access to steel mills CR now has

Some classification work to be absorbed at Bellevue (NS)

Motor Yard (CR) - retain

Buffalo

Frontier (CR) - consolidate NS operation into CR

Pittsburgh

Conway (CR) - primary facility
Rook (NS) - [convey]

Cincinnati/Columbus

Cincinnati terminals consolidated

Gest Street (NS) - intermodal

Sharonville (CR) - primary facility

Columbus terminals consolidated

Potomac Yard - Hagerstown

Move through Hagerstown some traffic now moving through Potomac Yard.

May operate Shenandoah - Enola (Harrisburg) inter-road trains

March 29, 1985

Lines Proposed for Sale or Transfer of Lease to Guilford and P&LE

Line	Route Miles						
	NY	PA	WV	OH	IN	IL	Total
Sale to Guilford							
NS Lines							
Buffalo-Cleveland	68.2	43.9		75.6			187.7
Douglas-East St. Louis				34.4	169.5	176.1	380.0
Kokomo-Indianapolis					55.9		55.9
Cloggville-Knob				2.3			2.3
CR Lines							
Crestline-Gary				111.7	146.3		258.0
Carrothers-Walbridge				55.4			55.4
Adams-Decatur					16.2		16.2
Total-To Guilford	68.2	43.9	-	279.4	387.9	176.1	955.5
Sale/Transfer Lease to P&LE							
NS Lines							
Connellsville-Pittsburgh Jct.		86.1	4.8	20.3			111.2
Clairton-Pierce		5.6					5.6
Mifflin-Longview		3.5					3.5
West End-West Belt Jct.		2.3					2.3
Pittsburgh Jct.-Yeomans				128.6			128.6
Cleveland Belt Line				5.4			5.4
Cleveland-Harmon				72.7			72.7
Harmon-Zanesville				70.5			70.5
Chagrin Falls Branch				8.2			8.2
Carrollton Branch				27.7			27.7
Minerva Branch				3.0			3.0
Massillon Branch				16.5			16.5
Canton Belt Line				3.7			3.7
Steubenville-Martins Ferry				20.9			20.9
CR Lines							
Carnegie-Bridgeville		3.9					3.9
Total-To P&LE	-	101.4	4.8	377.5	-	-	483.7
Grand Total	68.2	145.3	4.8	656.9	387.9	176.1	1439.2

March 29, 1985

Proposed Guilford and P&LE Trackage Rights

		Route Miles*			
Line		OH	IN	IL	Total
Guilford Trackage Rights					
Cleveland-Crestline	CR	72.2			72.2
Berea-South Lorain	CR	17.5			17.5
Bucyrus-Carrothers	NS	13.7			13.7
Toledo	CR	1.8			1.8
Toledo	NS	5.8			5.8
Gary-South Chicago	CR		6.8	1.5	8.3
Kokomo	CR		0.3		0.3
Frankfort	NS		1.5		1.5
Total-Guilford		111.0	8.6	1.5	121.1
P&LE Trackage Rights					
Toledo-Yeomans	NS	51.1			51.1
Youngstown-Kent	CR	50.1			50.1
Mingo Jct.	CR	1.5			1.5
Total-P&LE		102.7	-	-	102.7
Grand Total		213.7	8.6	1.5	223.8

*In addition, trackage rights needed by P&LE over CR, if any, to establish a through route between McKees Rocks and Bridgeville, PA.

March 29, 1985

Proposed NS/CR Abandonments after Divestiture

Line	Route Miles Abandoned OH	IN	IL	Total
NS				
Cleveland-Rocky River	4			4
Lorain-Oak Point	8			8
Huron Branch	12			12
Shinrock Connection		2		2
Kokomo-Peru		14		14
Peru-Rochester		22		22
Plymouth-Dillon		16		16
Belfast-Michigan City		7		7
Delmont Jct.-Montpelier	47			47
Wakarusa-Dillon		30		30
Pine-South Bend		8		8
Lafayette-Rankin		34	19	53
Gibson City-Bloomington			33	33
Total NS	73	131	52	256
CR				
Danville-Urbana			29	29
Clermont-Logansport		72		72
Lebanon-Altamont		31		31
Union City-Red Key		22		22
St. Louis Terminal			9	9
Mingo Jct.-Bowerston	32			32
Cadiz & Hanna Branches	9			9
Total CR	41	125	38	204
NSCR Total	114	256	90	460

March 29, 1985

TRAFFIC DIVERSIONS

The estimated impact of Norfolk Southern's acquisition of Conrail on other rail carriers is shown on the attached schedule. The first column on the attached schedule totaling $165.1 million reflects the extended haul of one carrier's (Norfolk Southern or Conrail) traffic over the other carrier. The second column showing net gains of $68.8 million to NS reflects the theoretical potential of NS' maximizing its haul over its own lines in a deregulated environment as a result of adopting Conrail's aggressive routing policy. Both of these gains would be reduced as a result of concessions Norfolk Southern has offered to make to small eastern carriers operating in Conrail territory, the divestiture of lines required by the Department of Justice, and the National Industrial Transportation League (NITL) and Association of American Railroads (AAR) accord on preservation of competitive joint line rates and routes. Because of the NITL/AAR agreement Norfolk Southern-Conrail will not cancel all competitive joint line rates between points where the Norfolk Southern-Conrail consolidation make single-system rates possible.

Traffic Diversion Study*
Gross Revenue Gains or (Losses) to NS-CR
(millions)

Affected Carrier	NS-CR Consolidation Gains	Net Routing Gains	Net Gain or (Loss)
CSX	$ 40.4	$ 2.5	$ 42.9
CNW	41.8	3.6	45.4
UPMP	18.9	21.5	40.4
ATSF	18.0	(3.9)	14.1
BN	13.7	15.7	29.4
ICG	10.3	5.8	16.1
Guilford	7.8	4.2	12.0
GTW	6.5	9.3	15.8
Milwaukee	7.0	5.4	12.4
KCS	3.7	4.0	7.7
RF&P**	NA	NA	NA
Other	(3.0)	0.7	(2.3)
NS-CR	$165.1	$68.8	$233.9

May 1984

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* Before concessions to small eastern carriers, divestiture of lines required by Department of Justice, and AAR/NITL Agreement.

**RF&P is treated as part of CSX. Separate figures not available.

NORFOLK SOUTHERN CORPORATION'S ANSWERS TO QUESTIONS SUBMITTED BY SENATOR DENTON

1. What is the track record of your two railroads, N&W and Southern, in terms of profitability?

Norfolk and Western and Southern have an excellent track record, both separately prior to 1982 and subsequent to the Norfolk Southern consolidation. Both have long-standing reputations of profitability and good management. Profits are derived from railroad operations and are not diluted significantly by non-rail holdings. Net income after taxes for Norfolk Southern (and its predecessors, consolidated) are as follows:

Year	$ (Millions)
1984	$482.2
1983	356.5
1982	461.8
1981	569.2
1980	477.9

2. Under measures of cost efficiency such as operating expense per revenue ton mile, how do N&W and Southern compare to other Class I railroads?

Norfolk and Western and Southern compare very favorably with other major railroads under measures of cost efficiency. Over the years both railroads have been at or near the top in most of the traditional indices. In 1983 (latest year available) operating expense per revenue ton mile, compared with other eastern railroads, was as follows:

Operating Expense Per Thousand Revenue Ton Mile - 1983

NW	$32.6
Southern	30.0
Chessie	36.0
Seaboard	31.4
Conrail	41.2

1984 operating ratios (operating expense percent of total operating revenue) among the eastern majors were:

Operating Ratios - 1984

NW	80.9
Southern	78.3
Norfolk Southern	79.6
Chessie	90.6
Seaboard	86.1
CSX	88.0
Conrail	86.5

3. If there is an economic downturn, is Conrail better off by itself or as part of a larger rail system?

Conrail will be better off as part of a larger rail system, such as Norfolk Southern, for several reasons:

- In railroading the longer haul traffic is usually more profitable. Conrail's long haul routes are restricted to east-west traffic at present because for Conrail they are the most profitable. As part of Norfolk Southern, north-south long hauls will be possible as well. When margins shrink during a recession, the more long haul freight being carried, the better off the rail system as a whole.

- Conrail's traffic is composed in large measure of highly competitive merchandise traffic. The margin on this traffic is extremely thin in times of recession making profitability difficult. Norfolk Southern's traffic mix, which is different from Conrail's, will be helpful in such times.

- Norfolk Southern carries more coal than Conrail. Although this commodity experiences its own cycles, they are not always tied to the domestic economy. Coal provides a diversity in the traffic mix that can help the overall system weather a recession better.

4. If you buy Conrail, do you foresee at any time in the future coming back to the federal government for more public funding to run the railroad?

Absolutely not. In the current regulatory environment Norfolk Southern has the flexibility necessary to adjust its operations to profitable levels. Norfolk Southern foresees no return to government funding of Conrail's freight railroad operations.

NORFOLK SOUTHERN CORPORATION'S RESPONSES TO QUESTIONS SUBMITTED BY SENATOR BYRD

Question:

Will the Conrail/Norfolk Southern merged entity effectively be in a position to deny CSX originated coal access to the Northeast markets?

Question:

What guarantee do we have that this will not occur?

Answers:

Norfolk Southern/Conrail will not be in a position to deny CSX originated coal (or any other traffic) access to Northeast markets. For traffic now moving in single system CSX service, Norfolk Southern's purchase of Conrail will have no effect.

CSX coal interchanged with Conrail today should continue to move via the same routes after the Norfolk Southern/Conrail affiliation. Norfolk Southern assumes this traffic is now profitable for Conrail, and we want to retain profitable traffic. Also, Norfolk Southern does not have on-line equivalent coal to substitute for CSX's northern West Virginia coal. That CSX coal is high sulphur. While its marketability may be affected by future regulatory restrictions, its interchange with Conrail will not be foreclosed by Norfolk Southern's purchase of Conrail.

Norfolk Southern supports the intent (and adoption by the ICC) of the agreement on joint rates and routes entered into between the National Industrial Transportation League (NITL) and the Association of American Railroads (AAR). This accord will provide additional protection for CSX access to the Northeast for coal movements. The NITL/AAR agreement assures that at least two competitive routes will exist between each origin-destination pair for all commodities, including coal, where competitive routes exist today or existed prior to the Staggers Act. For rates and routes currently published in tariffs, at least one route competitive with the Norfolk Southern/Conrail single system route will be preserved. Carriers will of course be free to negotiate contract rates over all routes.

Question:

What potential, if any, does Norfolk Southern see for market development in West Virginia as a result of this merger for (a) coal and (b) chemicals?

Answer:

As a result of Norfolk Southern's purchase of Conrail, market access for West Virginia coal and chemicals will be improved. For coal the improvements will fall in two categories. First, West Virginia mines served by Conrail will gain shorter and more direct single system routes to Northeast markets. Today Conrail's only route out of West Virginia goes northwestward to Columbus, Ohio. While this is good for destinations in the Midwest, it creates great circuity for Conrail movements to the Northeast. The combined Norfolk Southern/Conrail route system, through a connection at Deepwater Bridge, will provide a new single system outlet for Conrail's West Virginia coal. This coal will move more efficiently up the Shenandoah Valley and via Hagerstown, Maryland, to the Northeast or eastward for export.

Second, West Virginia coal will have access via single system service to greatly expanded markets. Mines on Conrail will be able to move on the Conrail/Norfolk Southern system to utilities in the Southeast. The costs and delays of interchange will be eliminated, and because Conrail will no longer face a short haul, the marketing incentive will be greater.

Chemical traffic from West Virginia will enjoy the same service and access benefits. Those industries along Conrail's Kanawha Valley main line will have more direct and efficient single system routes to the Northeast, and the disincentive of Conrail's short haul for movements to the Southeast will be eliminated.

Question:

If you see market development potential, does Norfolk Southern have plans to pursue this and what could it mean to West Virginia in terms of tonnage and jobs?

Answer:

Norfolk Southern definitely plans to work with West Virginia customers to pursue the marketing opportunities noted above. For example Norfolk Southern is committed to Conrail's completion of any tracks and related facilities necessary to promote aggressively the new Beth Energy mine in Nicholas County. Norfolk Southern has a long history Of promoting the development of large blocks of coal reserves and will pursue additional markets for this coal in the Northeast and Southeast, as well as export markets and water served customers on the East Coast.

Norfolk Southern and Conrail already have a connection at Deepwater Bridge, so the physical facilities are already in place to take advantage of expanded markets for West Virginia traffic. These more efficient routing options and new markets can be realized by Norfolk Southern/Conrail without elimination of existing competition because Norfolk Southern and Conrail now serve different areas of West Virginia. The combined Norfolk Southern/Conrail will have only 31 percent of West Virginia coal shipments by rail, compared with 69 percent for CSX.

Question:

Under the proposed merger, are any of Conrail's tax benefits available to Norfolk Southern after the merger?

Answer:

Following acquisition of Conrail stock by NS, Conrail will become a member of the NS affiliated group, and the tax basis of its assets will be available for Conrail to use in the consolidated tax returns of the NS group.

NS believes that it should be accorded the same tax treatment as any other purchaser. Generally, the tax laws provide that the depreciation deductions of a corporate member of a consolidated group (as Conrail will become) can, if such deductions exceed that member's own separate income, be used to offset consolidated group income. There is a question whether under the terms of NS' acquisition of Conrail stock, NS would be entitled under IRS rules and regulations to offset all of Conrail's depreciation (to the extent it exceeds Conrail's income) against NS income. Such questions will be resolved under existing Internal Revenue Code Regulations.

Senator McConnell. The next witnesses in a panel are Gordon Neuenschwander, executive vice president, Pittsburgh & Lake Erie Railroad, Pittsburgh; and Timothy Mellon, chairman and chief executive officer of the Guilford Transportation Industries in New Haven.

I might say, Mr. Neuenschwander, I hope you never contemplated running for public office. They would never get your name on a bumper sticker.

Mr. Neuenschwander. As a matter of fact, I did, but at the local level.

Senator McConnell. The best buy on Madison Avenue could not have handled that one. Gentlemen, if you have no objection, we would like for you to submit your full statements for the record, and if each of you would consecutively take no more than 5 minutes, if that is what you are planning on doing, or are you just planning on one——

Mr. Neuenschwander. Which would you like to go first, sir.

Senator McConnell. We would like both of you back to back before we get to questions. That is what I am suggesting, and we would like to limit each of you to 5 minutes. If you want to take less than that, that would be of course wonderful. Go right ahead.

STATEMENTS OF GORDON E. NEUENSCHWANDER, EXECUTIVE VICE PRESIDENT, PITTSBURGH & LAKE ERIE RAILROAD CO.; AND TIMOTHY MELLON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, GUILFORD TRANSPORTATION INDUSTRIES

Mr. Neuenschwander. My name is Gordon E. Neuenschwander and I am the executive vice president of the Pittsburgh & Lake Erie Railroad Co. headquartered in Pittsburgh, PA.

We are one of the two regional rail carriers that Secretary Dole had announced will play an important competitive role in relation to the Norfolk-Southern/Conrail combination that is proposed.

I would like to start out by saying that as Bob Claytor mentioned, he has been in railroading most of his life and his career; I have been, too. I started out in Senator Metzenbaum's home city with the Nickel Plate Railroad for a short time, now a part of Norfolk-Southern system. I moved from there to the Pennsylvania Railroad Co. where I stayed for a number of years in Pittsburgh and then moved over to the Pittsburgh & Lake Erie Railroad Co. where I have spent many years in the railroad business. So I think I know something about it. And I know what competition is all about, too.

I would like to say right at the outset that the P&LE during the 1970's, the decade in which Conrail was born, was a highly profitable carrier. It was a part of the former New York Central system and then part of the Penn Central system.

As such it was far more profitable then the Penn Central Railroad Co. which was its corporate parent. We sent millions of dollars in dividends and payments to our parent company when they were flat broke. So the P&LE, I think you have to step back and indicate that it was a major, class I railroad until the last few years when Conrail emerged as a very strong, trimmed down fighting ship, if you will, largely because of the benefits the Federal Government has bestowed upon it.

During the period of time that we were profitable we acquired and spent our money and invested it heavily in railroad equipment, not on other things, but on railroad equipment. It was in 1980 and 1981 that we went overboard, no question about it, now that we see it in hindsight, in acquiring a tremendously large modern car fleet. We even spent $35 million in 1980 and 1981 buying modern hopper cars from the shops of the CSX Corp. We also acquired another $65 million worth of steel carrying gondola cars and other equipment of that type in order to serve the steel industries that are so important to both Conrail and the P&LE in the western Pennsylvania, eastern Ohio territory.

We are a home grown railroad. We are headquartered there. We think we know the business of railroading in western Pennsylvania and northeastern Ohio. We know our markets, and I will tell you that I think our reputation until the last 2 years was excellent in terms of our ability to compete with Conrail and Penn Central before that.

As a matter of fact, in the early years of Conrail's formation, the competitive balance as to the shippers that we both served, I think, was tilted in favor of the P&LE until Conrail got it back together, and it has done a marvelous job, no doubt about that. But the more marvelous a job it has done, the greater the P&LE has been hurt in recent years.

In terms of Conrail's sale I want to make two basic points. Congress must maintain regional competition. Regional competition is the key. As a result of this sale, whether it is Norfolk-Southern, whether it is sold to any other private entity, regional competition must be maintained, and the other point is that the only way it can be maintained is through a divestiture, which is the appropriate tool to accomplish this. It is the only effective way that it can be done. P&LE was created to be a competitive weapon over 100 years ago to fight the monopoly of the Pennsylvania Railroad Co. in western Pennsylvania. We survived and we thrived and did well in that role.

The tables have now turned. We are the underdog. After 1976 we had to turn to friendly connections since Conrail turned out to be a hostile competitor to us. So we turned to the Norfolk-Southern and also to the Chessie System to do greater interline business. We are a short railroad. Some of the big shippers say we do not go anywhere, but we certainly have been an effective competitor for them.

We prospered in that way and have relied upon Norfolk-Southern to help in our competitive efforts. With this proposed combination on our hands P&LE's major competitive partner, Norfolk-Southern would now become the partner of our major competitor, Conrail. Under that circumstance we say that divestiture is the only appropriate tool to provide some measure of competition in the impacted region.

Norfolk-Southern has embraced the DOJ directive in this regard. We are participating in its implementation, that is of the DOJ directive, through our negotiation with Norfolk-Southern. Although we cannot appear here today to say that the specific lines of the divestiture will result in a perfect competitive solution, we can and do support the proposed combination of Norfolk-Southern and Conrail if the conditions upon which the required divestiture is based are fully implemented. Adherence to these conditions and the Justice Department's vigilance in enforcing their full implementation is essential if competition in the region is to be preserved following the Norfolk-Southern purchase of Conrail.

For our part we are prepared to do a lot more than we are now. We have a management, we have surplus equipment, and we are prepared to go on this venture, and we think we have the money that can be brought to bear because the new venture we see is one in which investment will move not to the P&LE that you see today, but in this new venture we can become an effective, viable competitor for the long term future. I thank you.

[The statement follows:]

STATEMENT OF
GORDON E. NEUENSCHWANDER, EXECUTIVE VICE PRESIDENT
PITTSBURGH AND LAKE ERIE RAILROAD COMPANY
BEFORE THE
SENATE JUDICIARY COMMITTEE
WASHINGTON, D.C.
MARCH 27, 1985

My name is Gordon E. Neuenschwander. I am the Executive Vice President of the Pittsburgh and Lake Erie Railroad Company ("P&LE"), one of two regional rail carriers Secretary Dole has announced will play an important, competitive role in relation to a combined Norfolk Southern/Conrail system.

Without divestiture of certain track and rail-related facilities, and agreement as to essential operating terms and conditions, the P&LE and its affiliated railroads could be seriously and adversely affected by a combination of Conrail and Norfolk Southern ("NS"). NS, however, in an effort to meet the concerns expressed by the Department of Justice in its January 29, 1985, letter to Secretary Dole, has agreed to transfer to the P&LE by sale, lease, and trackage rights approximately 500 miles of lines and rail related facilities. Acquisition of such properties, upon appropriate terms and conditions, would permit the P&LE to reclaim its former position as a strong regional carrier and would provide certain shippers with a viable, competitive alternative to an enlarged NS system.

By way of background, the P&LE operates over approximately 500 miles of track, running over its own lines from Brownsville and Connellsville in southwestern Pennsylvania, through Pittsburgh, where it is headquartered, to Youngstown, Ohio, and by trackage rights over Conrail and NS lines to Shenango, Pennsylvania, Ashtabula, Ohio and Buffalo, New York.

Throughout its first hundred years, during which it was a corporate subsidiary of the New York Central System, the P&LE operated profitably and thrived upon the movement of large volumes of iron ore, coal, iron and steel, and other industrial products. The New York Central and Pennsylvania railroads merged in 1968 to form the Penn Central. After its bankruptcy in 1970, the Penn Central railroad properties were taken by the Government, in 1976, to form Conrail. The P&LE was not included in this transfer. Instead, P&LE was retained by the Penn Central trustees until 1979 when it was sold to private owners who control it today.

As originally envisioned by the U.S. Railway Association (USRA), Conrail was to have been somewhat smaller than its ultimate configuration, with other eastern railroads purchasing certain of the ex-Penn Central and Erie-Lackawanna properties. The competitive environment envisioned by USRA, however, did not occur, and USRA, in its Final System Plan, recognized that Conrail would require pervasive federal regulation to temper and control its monopolistic power.

An integral part of the Final System Plan was the maintenance of smaller regional carriers, such as the P&LE. USRA believed that implementation of the Final System Plan would improve the economic prospects of these smaller carriers by directly strengthening their lines and they, in turn, would help restore a level of certainty to rail service and routes in the affected region which had not existed since the Penn Central bankruptcy.

That was the situation nine years ago. Since 1976, rather than more regulation and more competition, as envisioned by USRA, Congress and the ICC have significantly deregulated the railroad industry and Conrail has adroitly exploited its newfound power with a vengeance. It has canceled many important joint rates and routes. It has set rates and switching charges in such a way as to exclude competition. Conrail's anticompetitive activities have been especially devastating to the P&LE since Conrail, in large part, is comprised of the P&LE's old corporate parent and principal friendly connection, the New York Central.

Since Conrail's formation, the P&LE has sought and fought to maintain its traditional role as a competitor in the Pittsburgh-Youngstown area. This effort has become extremely difficult due, in large measure, to a downturn in heavy industry in the Pittsburgh-Youngstown area, and the impact of Conrail's unfair competitive practices. In recent years, the annual volume of P&LE business has dropped from 300,000 carloads or 19 million tons, to half that amount. Yet, the P&LE has survived. Its survival under these conditions is known in the industry to be the result of vigorous cost cutting, effective management, and the loyal support of shippers and creditors.

To provide shippers with an effective alternative to Conrail, the P&LE has relied substantially on NS as a friendly east-west connection, replacing the old New York Central. In 1983, for example, 27% of P&LE's interline revenue was derived from joint hauls with NS in movements which were competitive to Conrail single line hauls. This revenue, the competitive rail service which it represents, and the future of the P&LE and its customers could be placed directly at risk if the combination of NS and Conrail were allowed to proceed without remedies designed to preserve competition.

In order to preserve some of the competition which otherwise would be lost, the Department of Justice, by its letter of January 29th, has required divestiture of certain assets and adherence to certain conditions by NS. We have carefully studied the Department of Justice letter. Adherence to its conditions by NS will not enhance competition, or create the level of competition originally envisioned by USRA, or preserve competition in every market impacted by the NS/Conrail combination. Such conditions, however, are a very important step in the right direction.

Representatives of NS have stated that they will embrace and abide by the conditions of the Justice Department's letter. In furtherance thereof, the P&LE has been actively negotiating with NS respecting the acquisition of rail lines and facilities. Although certain essential terms have yet to be resolved, agreement has been reached as to 500 miles of lines which NS is willing to divest and P&LE is willing to acquire.

Although we cannot appear before you today and say that the properties to be divested by NS and acquired by the P&LE and by Guilford Transportation Industries provide a perfect competitive solution, P&LE can support the proposed combination if the conditions upon which it is based are fully implemented. We believe that the divestitures and other conditions set forth in the Department of Justice's January 29th letter, and embraced by NS, will help retain some measure of service and pricing competition in the affected markets.

For its part, the P&LE is prepared to play a significant role in a truly competitive rail system within the impacted region. The lines over which the P&LE will operate once an agreement with NS is consumated will allow P&LE to serve shippers directly as far west as Toledo, Ohio where it will gain a vital link with the Grand Trunk Western Railway. The lines to be acquired by the P&LE also will provide a possible opening to the Southeast via Connellsville, Pennsylvania, as well as Cleveland, Ohio, on the north. Of course, service will be provided to many communities and important shipping areas between these points. Such acquisitions and trackage rights by the P&LE will provide area shippers with an alternative, viable, competitive rail service.

While the P&LE has suffered a serious decline in its revenue base from the highly profitable levels it had experienced for many years prior to 1981, it remains prepared and equipped to serve an expanded area under the proposed divestiture plan. Some evidence of this can be found in the fact that the P&LE operates the largest fleet of freight cars of any regional carrier. This fleet numbers close to 14,000 freight cars of various types found on most major railroads. It includes large number of cars which are well suited to serve the types of industries which are located along the lines that P&LE will acquire from the NS.

Because of current low traffic levels on the P&LE's present system, a significant portion of its car fleet is not adequately utilized and is available for use in expanded operations. The same is true with respect to the 100 unit locomotive fleet operated by P&LE. In addition, the P&LE has a dedicated management team which has had extensive "hands-on" operating experience both with the P&LE, and, in many cases, with other larger railroads.

I thank you for the opportunity to address some of the important issues which are before you today.

Senator McConnell. Thank you.

STATEMENT OF TIMOTHY MELLON

Mr. Mellon. Mr. Chairman and members of the committee, my name is Tim Mellon. I am chairman and chief executive officer of Guilford Transportation Industries. I have written testimony which I would like to submit in its entirety for the record, and I would like to cover briefly by reading from a summary. I would then be pleased to answer any questions you might have.

As soon as Secretary Dole announced that Guilford had reached an agreement in principle with Norfolk-Southern to acquire lines to satisfy the competitive issues raised in the Justice Department memorandum to the Secretary, we met with representatives from the Justice Department to determine what data they would require to perform an analysis of our proposal.

At the same time we began a more detailed analysis of the traffic to develop as accurately as possible an estimate of new traffic this system might attract over the Chicago and St. Louis gateways. And also we had to determine the traffic that may flow over the system as a result of reciprocal switching arrangements proposed by the Justice Department.

In the next few weeks we will provide an operating plan and comprehensive revenue projections which will be responsive to questions posed by the Justice Department, and many of the groups that have expressed an interest in our proposal.

I would like to provide you with some information regarding the markets and traffic that we expect to compete for. The primary commodity that presently originates on the Guilford system is paper and paper products. Much of this traffic originates in northern New England and flows to the west. In fact, a very high percentage of our traffic terminates in Indiana, Illinois, and further west. Most of this business can move over our new system once these lines are acquired.

While paper is certainly our strongest commodity we have been successful in the past few years in several other lines of business. For example, today we handle a significant amount of automobile traffic coming into New England. We are familiar with the automobile business and look forward to building on our existing success in this area.

One area that has great potential for us is the movement of grain to the East, both for domestic consumption and for export. Over the past several years our grain business has grown and continues to be strong. With the ability to access grain producing regions and to originate our traffic on our own lines we will become stronger in this market both for domestic consumption grains and for new export markets.

Over the last several weeks we have visited with several ports in our service area, and they have all indicated an interest in working with a new, low-cost carrier such as ours to attract new export business.

And I might say there was quite a bit of interest in the Port of Philadelphia to develop new business with our lines.

Another line of business which we have had great success with is the intermodal business. We are particularly proud of our success in this area because many of the intermodal hauls on the Guilford system are considerably shorter than those generally considered to be profitable by other long haul carriers.

However, even though our lengths of haul are short we have been successful in building our business. In fact, last year we experienced a 9-percent increase in our intermodal traffic over 1983. And we attribute that increase to our ability to provide a consistent service at a competitive price.

We believe that our success in the intermodal business in our highly competitive circumstances in the Northeast will provide us with a sound base for attracting longer haul intermodal traffic coming across the Chicago and St. Louis gateways.

In addition to giving you some of the types of markets that we believe our system will be competitive in, it may also be helpful to you if I were to give you some idea of the way we intend to operate the new railroad lines. The Guilford system today operates its main lines at 40 miles an hour. We have found that a 40 mile an hour speed in our region is cost effective and also fuel efficient.

We have also found that at 40 miles per hour with consistent service we have been competitive in the marketplace. It is our intention to maintain our new lines for a freight speed of 40 to 50 miles an hour. Naturally, the Amtrak speeds we would keep at their present speed.

At these speeds we will be able to maintain our position as a low-cost carrier while at the same time offering consistent service. We have also designed this system so that it will not be encumbered by superfluous yards and terminals. By designing this type of efficiency into the physical structure of our railroad we will be competitive on our transit times with other carriers competing for long haul business between the eastern seaboard and the Midwest.

The key to attracting business will be our ability to provide efficient service on a consistent basis. Our new railroad is designed to do just that. Guilford has analyzed this acquisition proposal with the full understanding that while we enjoy a cooperative relationship with Norfolk Southern to support their efforts to acquire Conrail, we will continue this cooperative yet competitive relationship the day we complete this transaction, just as we compete with CSX, the Canadians, and others.

We did not agree to acquire these lines without a complete understanding of the competitive environment we will operate in. Guilford has supported the competitive aspects of the Staggers Act and looks forward to competing over this new system.

To make this investment under any other expectation would be foolish.

Finally, I think it is important that we must learn from the past. Conrail in the last 3 years has made great strides. Its management deserves the recognition they have received for restoring that railroad to sound financial health. We must, however, never permit our railroads in the Northeast to return to the condition we all remember in the sixties and seventies.

The sale of Conrail to Norfolk Southern is the best assurance we all have that it will not happen. That is why we support them. It is essential now that Congress move to complete this return of Conrail to the private sector through the sale to the Norfolk Southern. I have here a map of our existing system on the right and new lines to be acquired on the left. If you have questions we can refer to the map.

Senator McConnell. OK. Thank you. The Chairman has some questions that he had prepared which we are going to supply to you all so that you can answer them for the record.

[Prepared statement and responses to the chairman's written questions follow:]

SALE OF CONRAIL HEARING

SENATE COMMITTEE ON THE JUDICIARY

MARCH 27, 1985

STATEMENT OF

TIMOTHY MELLON

GUILFORD TRANSPORTATION INDUSTRIES

Mr. Chairman and Members of the Committee, thank you for giving me this opportunity to come here today to discuss the proposed sale of Conrail to the Norfolk Southern and the interest that Guilford Transportation Industries has in that sale.

Since 1981, we have assembled a strong, competitive regional rail system in the northeastern part of this country. The process has involved direct negotiations between Guilford and various sellers. It has involved every State in the region that we serve and their Transportation Departments. It's involved many shippers and perhaps most importantly, the employees of each of the railroads that we have purchased. The premise behind the creation of the Guilford system has been that there is an opportunity in the Northeast; an opportunity to provide efficient rail freight service to both existing shippers and new ones that may be attracted to our system; an opportunity to work with State and local governments and with the private sector to attract new industry to our region and most importantly, to operate our system at a profit. We are pleased that we are presently operating in accordance with our expectations and we are satisfied with the progress we are making in assisting in the re-industrialization of our region of the country.

Before I talk specifically about the transfer proposal, I believe it would be helpful to explain a little about Guilford's involvement in this entire transfer process. In January of 1984, when we acquired the D&H and finished creating our Northeastern system, we felt that we faced a period of stability and were looking forward to molding three separate carriers into a single team. We were aware that we faced some of the strongest competitive circumstances that any railroad in our area has faced in many years. To our north, and in every New England state where we operate, we compete with the railroads which make up the Canadian government railroad system, the Canadian National the Central Vermont and the Grand Trunk. To our South, we compete with Conrail across our entire railroad. In addition, we compete in many areas with the Canadian Pacific. Each of these carriers are significantly larger than the Guilford system. Their revenues are measured in the billions of dollars. We were convinced that through coordinating the efforts of our three carriers and through scrupulous attention to our costs we could not only survive in a deregulated environment but we could indeed attract additional traffic. The experience of this past year has borne out our assumptions. I am pleased to tell you today that the Maine Central continues to be a strong profitable railroad, the Boston and Maine has seen its best year in certainly over twenty years, and is today a sound profitable railroad. The Delaware and Hudson, which many gave up for lost years ago, is returning to financial health. A year ago much of the D&H could not be operated safely at over 10 MPH. It was suffering from derailments, equipment failures and a myriad of other problems. Although problems still exist on that railroad, we are pleased that in one year, with the assistance of New York and Pennsylvania, we have rebuilt its track structure. The mainline of the Guilford system is now safe to operate over at 40 MPH, which is the proper speed for our railroad. We are pleased with the system as it is today and are confident that our first full year of operation provides us with a strong base for the future.

As I have said, after we acquired the D&H, we expected some stability in our region. That assumption was changed when we heard the announcement that the Norfolk Southern Corporation intended to submit a bid for the acquisition of Conrail. Since one of the main purposes of acquiring the D&H was to reach the NS in Buffalo, we were deeply concerned how their bid could affect our future. It appeared clear that a sale of Conrail to NS would at a minimum require the cessation of service by the D&H, and the loss of over 1,300 jobs in Pennsylvania and New York. While the D&H provided the Guilford system a vital link to markets and shippers in the midwest through our connection with the NS, we realized that a sale of Conrail to NS would deprive us of access to those markets and to the competitive traffic that NS offered us in Buffalo. That caused us to seriously evaluate the measures that might be necessary for us to counter such a bid. One option we looked at was the submission of a bid ourselves to acquire Conrail. We decided to go ahead with that bid and formally submitted our offer to the U.S. Department of Transportation last June. At that time, we submitted what we considered the highest serious bid of $1.2 billion cash plus the relinquishment of the same tax benefits that any other bidder would be expected to relinquish. As the review process by the Department continued throughout the summer, it became evident that the list would be reduced and by September, the final bidders on the Department's list were the Norfolk Southern, Alleghany, and the financial group headed by Mr. Marriott.

Once the list was reduced to three, we felt it essential to again evaluate each of the bidders to determine which would meet the same criteria that we used in originally submitting our bid for the entire system. We realized that our region of the country could not once again suffer the type of decline our railroads suffered back in the 1960's and early 1970's and we also realized that for the Guilford system to flourish it was essential to have a Conrail system which would remain strong and competitive. While we compete vigorously with Conrail in many areas, we also interchange a substantial amount of traffic with Conrail. For us to remain competitive, it's also essential that Conrail remain strong.

For that reason, we felt that a prospective buyer should meet several criteria. First, the buyer not only had to be committed to the successful operation of the railroad, but had to, in our minds, have clearly demonstrated that commitment. Second, the buyer had to have the managerial ability and talent to continue the progress that Conrail has demonstrated in the past three years. Third, the buyer clearly had to have the financial resources to guarantee the maintenance of Conrail's physical plant and to insure operations in times of financial growth as well as during times of recession. Fourth, the prospective buyer had to have the ability to finance the acquisition in a prudent manner which was satisfactory to the government. In looking at the three prospective buyers that the Department was evaluating, it was clear to us that the one that stood out above all others was Norfolk Southern.

The determination that Norfolk Southern was the best buyer for Conrail may sound somewhat contradictory to my earlier statements that acquisition by Norfolk Southern could also seriously impact the financial health of a large segment of the Guilford system. I believe our support must be taken in context with our prior dealings with NS. You may be aware that the D&H was acquired by Guilford from NS. Throughout all of our negotiations on the D&H, we were impressed by the integrity of the entire NS team. We developed a trust for their word and an understanding that they would live up to their commitments. And while we had secured no concessions from Norfolk Southern to protect Guilford traffic or any of the other measures that are traditionally imposed on mergers of this size, we felt confident that at the appropriate time and under the appropriate controls we would be able to sit down and work out our differences.

That process of working out our differences developed in the context of a review of the NS acquisition by the U.S. Department of Justice. Prior to the release of the Justice findings on this acquisition, we were requested by the Federal Railroad Administration to join with them in a meeting in Washington to explore our interest with NS in the acquisition of certain lines which would permit a competitive carrier to serve specific markets that Justice found would be lacking in competition if NS were to acquire Conrail. It was our understanding that FRA had met with other carriers regarding the proposed divestiture.

Following an initial meeting at the Transportation Department, Guilford began, in early January, a series of meetings with NS, which were at all times supervised by a representative from the US Dept. of Transportation under guidelines set up by the Justice Department. We were informed at the beginning of our negotiations that all discussions were to be at arms length. While the Department would play a supervisory role to insure that discussions were confined to those areas necessary to satisfy Justice Department concerns, all negotiations would be strictly commercial in nature, and would not be influenced by the government. We were also informed that any system that was finally agreed upon would have to pass review by the Justice Department to insure that it not only met their competitive concerns, but that it would also meet their test of financial viability. After a series of meetings, we indicated our interest in acquiring various lines which are depicted on the map which is attached to my testimony. Following expeditious negotiations, Guilford and NS reached an agreement in principle that the lines depicted on the attached map would be conveyed to Guilford by NS concurrent with a transfer of Conrail to NS. The system which we agreed upon is comprised of both NS lines and Conrail lines which in general will be excess to the NS/Conrail system when the sale is completed.

Once the line segments that Guilford was interested in were identified they were crosschecked by us and NS against the letter sent by the Justice Department to Secretary Dole to insure that the competitive issues were met and that the proposed system will satisfactorily meet the criteria set by Justice. We are confident that Justice will agree after it analyses the transaction.

In addition, our staff began a detailed physical inspection of each and every line segment. Within two weeks we physically inspected, by hi-rail, by train and by helicopter, every mile of track that we propose to acquire. The one exception to this is the track which is presently owned by Conrail which for various reasons we were unable to hi-rail. We did inspect the line by helicopter, by foot in some locations, and by riding over some line-segments on Amtrak. We have also reviewed with Amtrak the condition of the line. The Conrail line segments are in territory that several of our employees had direct responsibility for when they were employed by Conrail prior to joining Guilford.

As we were completing our physical inspection, we also performed an analysis of the traffic which is presently generated by the Guilford system which could flow over the new rail lines and of the local traffic which is presently on each of the line segments. Again, the specific traffic information was not available for the lines we would acquire which are owned by Conrail, and as a result, it was necessary to make some conservative estimates of the local traffic which would be generated on these lines segments. In all of our analysis of these lines, we at no time made any estimates of potential new traffic which would be generated through connections to other carriers in Chicago and St. Louis, although we are certainly aware that we will be providing competitive service from these gateways and will attract a certain percentage of this business. The key was to be conservative.

Based on this analysis, we have determined that the lines which we have selected in conjunction with our existing system will permit us to provide strong single-line competitive rail service from markets in New England and the Northeast to shippers throughout the midwest and through the St. Louis and Chicago gateways to shippers throughout the western part of the country. In addition, the new system will cover markets that were of concern to the Justice Dept. Acquisition of these lines by Guilford will, for the first time since the 1960's, provide for a truly competitive and cost effective freight transportation network for the northeast and midwest. The new system, in conjunction with the existing Guilford railroads, will provide midwestern shippers with direct access to markets throughout the Northeast, including; New York City through our terminal in Oak Island, Philadelphia, Washington DC and all of New England. Looking west, shippers in New England, New York and Eastern Pennsylvania will have available direct single-line competitive rail service to markets in the midwest and beyond through connections to all carriers in Chicago and St. Louis. This type of service has not been available to shippers and potential shippers in our region since the early 1960's.

I spoke earlier of the procedure that we used to make a decision to acquire these lines. It is important to distinguish this process from the process we are presently involved in. In analyzing these lines, we believe that one criteria for deciding to acquire them had to be based only on what traffic we know will be operating over these lines on the day after we close with NS. Just importantly, our criteria does not represent a true picture of what traffic we are about to attract. For example, in our review, we did not consider competitive traffic which we will attract over the Chicago to St. Louis gateway. We also did not consider the new traffic which we will compete for due to the reciprocal switching provisions in the Justice Department Memorandum.

As soon as Secretary Dole announced that Guilford had reached an agreement in principle with Norfolk Southern to acquire lines to satisfy the competitive issues raised in the Justice Department Memorandum to the Secretary, we met with Representatives from the Justice Department to determine what data they would require to perform an analysis of our proposal. At the same time, we began a more detailed analysis of the traffic to develop as accurately as possible an estimate of new traffic this system might attract over the Chicago and St. Louis gateways, as well as to determine the traffic that may flow over the system as a result of reciprocal switching arrangements proposed by the Justice Department. In the next few weeks, we will provide an operating plan and comprehensive revenue projections which will be responsible to questions posed by the Justice Department and many of the groups who have expressed an interest in our proposal.

I would like to provide you with some information regarding the markets and traffic that we expect to compete for. The primary commodity that presently originates on the Guilford system is paper and paper products. Much of this traffic originates in northern New England, and flows to the west. In fact, a very high percentage of our traffic terminates in Indiana, Illinois or farther west. Most of this business can move over our new system once these lines are acquired.

While paper is certainly our strongest commodity, we have been successful in the past few years in several other lines of business. For example, today we handle a significant amount of automobile traffic coming into New England. We are familiar with the automobile business and look forward to building on our existing success in this area. One area that has great potential for us, is the movement of grain to the east, both for domestic consumption and for export. Over the past several years our grain business has grown and continues to be strong. With the ability to access grain producing regions and to originate that traffic on our own lines, we will become stronger in this market, both for domestic consumption grains and for new export markets. Over the last several weeks, we have visited with several ports in our service area and they have all indicated an interest in working with a new low-cost carrier such as ours to attract export new business.

Another line of business which we have had great success with is the intermodal business. We are particularly proud of our successes in this area because many of the intermodal hauls on the Guilford system are considerably shorter than those generally considered to be profitable by other long-haul carriers. However, even though our lengths of haul are short, we have been successful in building our business. In fact, this year we have experienced a 9% increase in our intermodal traffic over 1983, and we attribute that increase to our ability to provide a consistent service at a competitive price. We believe that our success in the intermodal business in our highly competitive circumstances in the Northeast will provide us with a sound base for attracting longer haul intermodal traffic coming across the Chicago and St. Louis gateways.

In addition to giving you some sense of the types of markets that we believe our system will be competitive in, it may also be helpful to you if I were to give some idea of the way we intend to operate this new railroad. The Guilford system today operates our main lines at 40 MPH. We have found that a 40 MPH speed in our region is cost effective and fuel efficient. We have also found that at 40 MPH with consistent service we have been competitive in the market place. It is our intention to maintain our new lines for a freight speed of 40 - 50 MPH. At these speeds we will be able to maintain our position as a low cost carrier while at the same time, offering consistent service.

We have also designed this system so that it will not be encumbered by superfluous yards and terminals. By designing this type of efficiency into the physical structure of our railroad, we will be competitive on our transit times with other carriers competing for long haul business between the eastern seaboard and the midwest. The key to attracting business, will be our ability to provide efficient service on a consistent basis. Our new railroad is designed to do that.

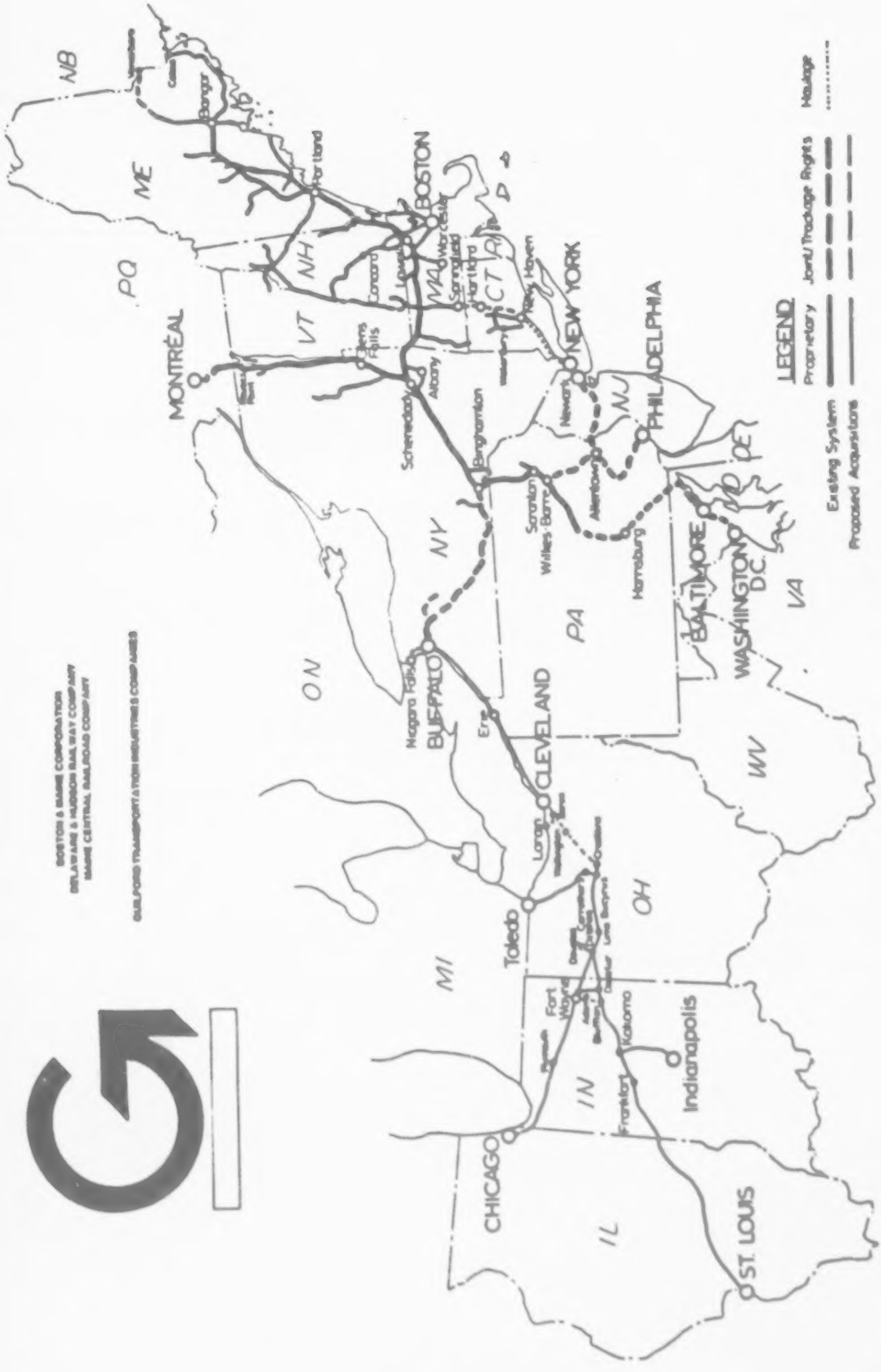
Guilford has analyzed this acquisition proposal with the full understanding that while we enjoy a cooperative relationship with NS to support their efforts to acquire Conrail, we will continue this cooperative, yet competitive relationship the day we complete this transaction, just as we compete with CSX, the Canadian's and others. We did not agree to acquire these lines without a complete understanding of the competitive environment we will operate in. Guilford has supported the competitive aspects of the Stagger's Act and look forward to competing over this new system. To make this investment under any other expectation would be foolish.

Mr. Chairman, I would like to point out an aspect of this proposal which members of this Committee might not be aware of. Two of Guilford's railroads presently operate Amtrak trains over their own lines. In addition, the Boston and Maine operates under contract with the Massachusetts Bay Transportation Authority all of the rail commuter service in the Boston area. We are proud of the fact that our commuter service boasts the best on-time record of any system in the country. We are equally proud of the relationship we have developed with Amtrak and all of the States we serve to help them foster passenger service. We look forward to extending this type of support to the States served by our new western lines. We will cooperate with Amtrak in providing service of the Broadway limited along our mainline from Crestline, Ohio through Fort Wayne, Indiana to Chicago, and we will cooperate with States and localities in their local endeavors.

While I have mentioned that we have had success in restoring financial health to two troubled railroads in the northeast, I would like also to bring the Committee up to date on other activities that Guilford is presently pursuing. Just recently, we applied to the Interstate Commerce Commission for national rights for a new trucking company, GMX, which we intend to operate both in conjunction with the railroad and independently. We intend to become a total transportation company with the resources to provide shippers and receivers with door to door service. GMX in conjunction with the lines that we will acquire as a result of NS acquisition of Conrail, will further strengthen our ability to compete with other long-haul carriers in our region. We expect that the ICC will approve these rights before Congress has completed action on the NS bid, and therefore, we will be in a position on the date of our closing to extend service by GMX immediately into our western lines.

Finally, I think it is important that we must learn from the past. Conrail in the last three years has made great strides. It's management deserves the recognition they have received for restoring that Railroad to sound financial health. We must, however, never permit our railroads in the northeast to return to the condition we all remember in the 1960's and 70's. The sale of Conrail to NS is the best assurance we all have that it will not happen, and that is why we support the sale. It is essential now that Congress move to complete this return of Conrail to the private sector through sale to NS.

Mr. Chairman, that ends my formal testimony, and I would be pleased to respond to questions that you or members of the Committee may have regarding our existing railroads or our proposed acquisition.


BOSTON & MAINE CORPORATION
DELAWARE & HUDSON RAILWAY COMPANY
MAINE CENTRAL RAILROAD COMPANY
GUILFORD TRANSPORTATION INDUSTRIES COMPANIES
LEGEND
Proprietary
Joint/Trackage Rights
Haulage
Existing System
Proposed Acquisitions
MONTRÉAL
PQ
NB
ME
NH
VT
MA
CT
RI
NY
NJ
PA
DE
MD
VA
WV
OH
MI
IN
IL
ON
Bangor
Portland
BOSTON
Worcester
Springfield
Hartford
New Haven
Lowell
Concord
Bellows Falls
Albany
Schenectady
Binghamton
NEW YORK
Newark
PHILADELPHIA
Allentown
Scranton
Wilkes-Barre
Harrisburg
BALTIMORE
WASHINGTON D.C.
BUFFALO
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Toledo
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ST. LOUIS

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GUILFORD TRANSPORTATION INDUSTRIES INC.

April 3, 1985

Senator Strom Thurmond
Senate Office Building
Washington, D. C. 20510

Dear Senator Thurmond:

With respect to questions to me about the proposed divestiture of certain rail facilities to Guilford Transportation Industries, as submitted by your staff, I am pleased to provide the following answers:

1. How did you become involved in the Justice Department divestiture plan? Did you initiate a proposal to the Justice Department? Had you been in contact with the Transportation Department?

   Guilford was contacted in early January, 1985, by Chris Rooney of the Department of Transportation in order to determine if GTI would be able and/or interested in participating in the acquisition of rail lines and properties from the proposed combined Norfolk Southern/Conrail so as to satisfy certain conditions that are to be imposed by the Department of Justice on the acquisition. GTI agreed to participate in discussions with Norfolk Southern, with the strict understanding that such discussions would take place under the auspices of the Department of Transportation and its ability to grant anti-trust immunity to such discussions. Later conversations with other railroads who were also interested in acquiring divested lines (specifically the Grand Trunk Corporation and the Pittsburgh and Lake Erie) took place with similar protection from Section 4.01 of the 4R Act (49 USC 333): GTI was thus provided the forum in which a general divestiture plan by Norfolk Southern could be accommodated.

2. How did you estimate the amount of new traffic that you might be able to generate on the tracks you might acquire? Where are the most promising sources of new traffic?

   Several categories of traffic were identified for analysis. Naturally, we considered all traffic currently originating or destined to customers along the acquired lines. Traffic data obtained directly from NS, and later by the FRA with respect to Conrail lines, is now being analysed. Estimates are also being made with respect to traffic that has origins or destinations on the present GTI system to determine how much could be hauled on the acquired lines as "overhead traffic" to other railroads. Further, we considered the possibility of generating new traffic, especially intermodal traffic, through a concerted marketing effort in those general areas to be served by the acquired lines. We will also have estimates of traffic that might be generated by friendly rail connections to the West and, most importantly, from those markets identified by the Department of Justice as requiring new reciprocal switching arrangements in order to mitigate or dilute the possible anti-competitive effects of the Norfolk Southern - Conrail combination. Of the many sources of traffic, this last category looks the most promising of all, if we are correct in our interpretation of DOT's criteria for selecting shippers that will be afforded competitive rail access.

3. Do you anticipate being profitable if you purchase divested tracks?

Absolutely. GTI will become even more profitable than it has been to date. We would not think of undertaking such an expansion if such were not the case. Our traffic studies and operating plans, when completed, will be forwarded to the Committee to clarify these assertions.

4. Who selected the lines that you might acquire? How much improvement will they require?

In the discussions described in the answers to question #1, we insisted to Norfolk Southern that, without direct access to western connections at both Chicago and St. Louis, the concerns of the Department of Justice would not be met. You will recall that DOJ calls for competitive service to and among certain gateways (St. Louis, Chicago, Buffalo, and Pittsburgh) in a corridor and to and among selected market areas within this corridor (e.g. Cleveland, Lorain, Buffalo, Fort Wayne, Indianapolis, and Detroit). Thereupon, Norfork Southern selected lines that provided reasonably direct access to and among these various locations. GTI executives and engineers, before agreeing to these lines, completed a physical survey of every mile of track and eacn wayside facility under discussion. Certain adjustments to the routes were then made, by mutual agreement, to satisfy operating requirements.

We anticipate normalized maintenance on these selected 1014 miles of route to annually approximate:

	Amount	Cost
Ties	60,000	$ 2.5 Million
Surfacing	350 miles	2.5 "
Rail	20 "	3.0 "
Other Materials		2.0 "
TOTAL ORDINARY		$10.0 "

In addition, approximately a three year program of extraordinary maintenance will be required to obtain reasonable transit times on the route between Kokomo, IN and Delphos, OH. Annually as follows:

Ties	40,000	$ 1.6 Million
Surfacing	150 miles	1.0 "
TOTAL EXTRAORDINARY		$ 2.6 "

Naturally these costs have been included in our operating and business plans.

5. Can a small railroad offering short hauls compete with a large railroad in the same region offering long hauls?

Yes, if sufficient business either originates or terminates on the small railroad. The overhead traffic however, is more subject to diversion by the larger railroad because of the ability of that railroad to market single-line service. Luckily, in this instance, the following phenomena mitigate towards the retention of competition:

a. GTI railroads originate and terminate considerable traffic in the Northeast. Much of this traffic is highly valued (paper, autos, coal).

b. GTI, having acquired the divested lines, will no longer be a "small railroad". In fact, its physical extent will exceed that of the present-day Conrail (St. Louis, MO to New Brunswick, Canada).

c. GTI will have direct access to the Western carriers at both Chicago and St. Louis and thereby provide those railroads with competitive eastern connections.

Senator Thurmond, I greatly appreciate the courtesies extended to Guilford Transportation Industries by your Committee and by Ken Starling. Please do not hesitate to ask, if there is more information that you might need.

Most sincerely,

Timothy Mellon
Chairman and Chief Executive Officer

TM/pcm

Senator **McConnell**. I have no questions. The Senator from Ohio.

Senator **Metzenbaum**. Mr. Neuenschwander, incidentally I am always pleased to have somebody here before us that has more letters in his name than mine.

Is there a parent company to P&LE?

Mr. **Neuenschwander**. There is a private company, Beloit Corp. out of Beloit, WI. It is a nonrailroad company that owns most of the stock of a small holding company in which I also happen to be at risk as a shareholder, and there is one other shareholder. Together we own the P&LE railroad. It is not the investment we bought 3 or 4 years ago, but it is what we have and we are fighting to keep it.

Senator **Metzenbaum**. And the parent company of Guilford?

Mr. **Mellon**. Guilford Transportation Industries is the parent company. The subsidiaries are in order of acquisition the Maine Central Railroad, which operates in Maine, primarily in Maine; the Boston and Maine Railroad, which operates primarily in Massachusetts and New Hampshire; and the Delaware and Hudson Railway Co. which operates primarily in the States of New York and Pennsylvania and also into the Province of Quebec.

Senator **Metzenbaum**. And what is the net worth of the Guilford Railroad Co., the operating company?

Mr. **Mellon**. As opposed to the holding company?

Senator **Metzenbaum**. No. Just what is its net worth?

Mr. **Mellon**. I am sorry. I do not understand. Which company are you asking about?

Senator **Metzenbaum**. The one that would be making the purchase from the Norfolk Southern.

Mr. **Mellon**. Well, the company that would technically be making the purchase would probably be the Boston and Maine Railroad Co., not Guilford directly.

Senator **Metzenbaum**. And what is its net worth?

Mr. **Mellon**. I do not have that figure at hand. I can get it for you.

Senator **Metzenbaum**. And has it been operating at a profit?

Mr. Mellon. Yes. In fact last year it had its most profitable year in a long, long time. Its net income—and this is before and after tax because there was no tax directly—was $7.8 million for 1984. That is an estimate, a preliminary result.

Senator Metzenbaum. And that is the best it has done in many years?

Mr. Mellon. Yes. The Boston and Maine was in bankruptcy up until the reorganization process through which we purchased the railroad. And it was reorganized on an equity basis. And there is essentially only very little debt on that railroad now, approximately $9 million of equipment type debt.

Senator Metzenbaum. You do not know its net worth?

Mr. Mellon. I am sorry; I do not. I presume it is our purchase price. Basically the railroad went through what is called push down accounting. I am not an accountant, but this is my understanding of it. Based on our purchase price, which was $24.25 million, and you would add to that the earnings of the Boston and Maine since our acquisition. They would be the $7.8 million for 1984 plus the $3.2 million net income from the last half of 1983. We purchased the railroad at the end of June of 1983. We have had it about 2 years now. So its net worth would probably be—I am guessing—it would be around $36 million.

Senator Metzenbaum. I am told that Guilford has a deficit of current assets minus current liabilities of $1.1 million; is that correct? I got that from Conrail.

Mr. Mellon. I do not have that figure. I do not expect it to be correct, though, if you got it from Conrail. There are a lot of other figures that you mentioned that were incorrect, for sure, and I do have the income figures. I do not have the working capital figures.

Senator Metzenbaum. So that we may have the correct figures, may we have your audited figures, then?

Mr. Mellon. Yes. Our audit will be finished, I think, this week or the next.

Senator Metzenbaum. And we would like to have them and going back since you have taken it over.

Mr. Mellon. Yes, Senator Metzenbaum. It is a complicated process the way we have taken over these railroads. The first we acquired in 1981, the Maine Central. It has been a profitable railroad for many years. The Boston and Maine, as I mentioned, was acquired in 1983 after a long process of bankruptcy in which it lost money year after year. It has made money in combination with our other railroads since we have had it.

The third is the Delaware and Hudson Railway, which again it was under different circumstances; it was essentially reorganized by contract, and we purchased that in—we do not even have a full year's figures on that. It was purchased in January 6, 1984.

Senator Metzenbaum. Can you tell me when you purchased the railroad, what capital was put into the railroad by Guilford Transportation?

Mr. Mellon. Our investment?

Senator Metzenbaum. Yes.

Mr. Mellon. Our investment in the Maine Central, the purchase price of the Maine Central was $18.5 million. The purchase price of the Boston and Maine——

Senator **Metzenbaum**. No. What I wanted to know was how much you actually put in. Was some of that debt? How much capital did you put in?

Mr. **Mellon**. We put nothing extra into the railroads per se because they were making a profit after they were reorganized. We did not have to invest anything more directly into the railroads.

Senator **Metzenbaum**. You paid $18 million——

Mr. **Mellon**. To the seller.

Senator **Metzenbaum**. To the seller.

Mr. **Mellon**. Yes. And they have generated both profits and cash each since we have had them, so we have not had to invest. They generate sufficient profit and cash to make the rehabilitations that are necessary on an ongoing basis.

Senator **Metzenbaum**. Are all three of your railroads making money?

Mr. **Mellon**. The Delaware and Hudson we have only had for a year now. It did not make money in the first year we had it as we expected it not to because there was considerable deferred maintenance.

When we took the Delaware and Hudson Railway over we could not operate trains at more than 10 miles an hour on that main line. We made a concerted effort last summer to rehabilitate the main line in southern New York, and in fact spent many millions of dollars upgrading that track to 40 miles an hour, which essentially our entire main line is rated at 40 miles an hour now.

Senator **Metzenbaum**. I am having trouble understanding why Conrail said you had a deficit of Guilford of $1.1 mllion, current assets minus current liabilities when you indicate your railroads are making a profit. So I think it would be helpful to us if we had the financial statements of all three of your railroads as well as Guilford.

Mr. **Mellon**. I think one area of misunderstanding, perhaps, by Conrail is they are using figures on each of these railroads before we acquired them. For instance, the Delaware and Hudson, there were no figures that relate to us before the end of last year. And those figures are not final yet. So I do not see how Conrail could have any figures on the subject.

Senator **Metzenbaum**. So that we may have the actual figures, will you be in touch with our staff so that we can get them for the four operations, Guilford and the three railroads.

Mr. **Mellon**. Yes, sir.

Senator **Metzenbaum**. Mr. Neuenschwander, I am advised that current assets minus current liabilities for the P&LE is $65.3 million.

Mr. **Neuenschwander**. That is correct.

Senator **Metzenbaum**. How do you keep going? How do you pay your bills?

Mr. **Neuenschwander**. The answer to that, obviously, Senator, is we are doing it with great difficulty. But we are and we are spending money on maintenance, $10 or $11 million a year on our track. We are meeting our payroll. All our trade accounts are current and that is equal to some of the best in the industry.

What we are doing, with the full agreement of our long term secured creditors, is deferring the payment of interest and lease charges on this tremendous equipment acquisition that we have made that is not being economically employed today.

And the collateral holders, the debt on that, is working with us on one of the longest handshake restructurings that I can remember, and we hope to have that cleared up in April at which time that net working capital deficit will be cleared up on the books. Accounting requires that our balance sheet show as current liabilities most of the portion of the interest and lease charges that have been deferred since July of 1983. That adds up to about $60 million right there.

As a matter of fact, it amounts to about $70 million. And if that situation is reversed you will see a break even or even a possible small positive net working capital situation. Once we sign the agreement——

Senator METZENBAUM. What is reversed? I am not quite clear on that?

Mr. NEUENSCHWANDER. How is that?

Senator METZENBAUM. What is reversed?

The accounting which now applies under GAP, you know, general accounting principles, which Arthur Anderson and any big eight firm would say we have to follow. What they have done is they have accelerated the payments immediately up to the short term and current debt situation out of long term debt. Our balance sheet will look considerably different and we will be happy and we are preparing pro formas and we obviously want to demonstrate to USRA, to DOJ, to this committee that we are willing to stand the scrutiny.

Your current liabilities are about $70 million?

Mr. NEUENSCHWANDER. Current liabilities are even greater than that, sir, on the balance sheet, $80 million. We have $23, $24 million in current assets, and as against that we have the large $80 million situation that you are referring to; that is correct.

As I say, there are four accounts under the ICC accounting rules that have been hit particulalry heavy, and we have deferred interest payments to the equipment security lenders, if you will, back to July of 1983.

Senator METZENBAUM. Thank you.

Senator SPECTER [presiding]. Mr. Neuenschwander, how do you propose to raise the capital to acquire the lines on divestiture, and make whatever upgrading is necessary to pull yourself into a position to make a profit here, given the difficulties you have from your financial statement?

Mr. NEUENSCHWANDER. We have arranged with private investment, a very small group, to supply the necessary funding, the equity that will meet tbe purchase price that has been discussed by Mr. Claytor and to actually supply some additional money up front take care of any upgrading. We think this will be modest based upon our close scrutiny and inspection of the particularly properties that we will be investing in.

Senator SPECTER. Mr. Neuenschwander, will you then be competing? Will P&LE be competing directly with the new entity, Norfolk/Conrail, assuming that the sale/merger goes through?

Mr. NEUENSCHWANDER. Yes, we will. The P&LE will be operating this new asset as well as its own lines, and we will be operating as a combined new system with longer hauls end with greater earnings potential.

Senator **Specter**. What is the prognosis for that given the enormous size, strength, and capacity of the merged system? If the giant decided to press you, could it?

Mr. **Neuenschwander**. No. We have faced this kind of competition before, and until Staggers was passed I think we were doing an excellent job in meeting the competition with Conrail and the large megacarriers head to head. At that time the rules of the game changed for the small carrier. What has to happen, we say, is the small carrier has to at least achieve some greater size.

I am not saying that this is the optimum size. However, I am saying we stand a far greater chance to achieve profitability and to be a competitive force in western Pennsylvania for our important shippers than we are today.

This is a great opportunity. We are excited as a management team to go at it.

Senator **Specter**. Well, Mr. Neuenschwander, I can see it as an opportunity. Everyone wishes you well if it works out in this direction. But in a context where the Secretary of Transportation has objected, as I understand it, and I have gone into it very deeply, to having Conrail maintained as an independent operation through a public sale and where you have the Department of Justice looking toward acquirers of divested lines for long term stability, aside from your own personal hopes and expectations, what is the objective view of your ability to make it?

Mr. **Neuenschwander**. My objective view, Senator, is very positive. For the first time the P&LE as a stand alone railroad will be able to reach some new markets, markets which have left us. The big industry not literally, but figuratively has gone south in our area and you know that as well as anyone in the Pittsburgh area. We are stuck to that territory.

The large shippers that we have have in fact moved somewhat west. This allows us to follow our familiar, important accounts in the Cleveland area, Canton, OH, Steubenville, OH. Those are the areas that we are going to make our money in. They are not that far away from where we are now. We have surplus equipment to dedicate to that service.

And in addition to all that we will have enough new working friendly connections in the Guilford Transportation Industries and we will reach Toledo, OH, where we will have a direct access, not having to go through an intermediate carrier to reach the Grand Trunk system and whatever business we can generate with them.

We know it is going to be a tough fight. Believe me, it is going to be tough. But we have taken risks before. I am going to be putting some of my own money into this. So I am sure hopeful it is going to work.

Senator **Specter**. Mr. Neuenschwander, when you say that so much of the action has gone south, I agree with you. That is a concern that I have about having the control of this Conrail system go to Norfolk Southern. That is the concern I have.

Mr. **Neuenschwander**. I said not literally. I said that figuratively. When business leaves we always say it goes south. I do not know why that is true, and I am sorry I used that reference particularly here.

Senator **Specter**. Well, I think it is an accurate reference, unfortunately.

Mr. Mellon, do you think that net liquidation value is a fair price to pay for the lines which you will be acquiring?

Mr. **Mellon**. Yes, basically.

Senator **Specter**. About how much does that amount to, if I may ask?

Mr. **Mellon**. The exact figure is determined by a very complicated appraisal. We do not necessarily agree that it will be quite as high as Mr. Claytor has indicated.

Senator **Specter**. A complicated appraisal?

Mr. **Mellon**. It is an appraisal process, yes, sir.

Senator **Specter**. How does it work? Is it scrap iron minus the cost of tearing it up?

Mr. **Mellon**. To my best understanding it is the cost of the materials recovered from the right of way as if they were sold on the scrap market or on the resale market plus the value of the residual land which has value really only to the adjacent land owners; for instance, a farm, if a railroad goes through a farm it would have farming land value per acre.

Senator **Specter**. Do you think you are paying too much for it?

Mr. **Mellon**. I do not know what the figure is yet so I cannot tell you that, but judging from what I have seen that is a very good railroad, and it seems to me a reasonable way to pay for it.

Senator **Specter**. If you have to pay net liquidation value to Norfolk Southern for the lines you are acquiring, why should Norfolk Southern not have to pay net liquidation value for the lines it is acquiring from Conrail?

Mr. **Mellon**. I cannot speak for Norfolk Southern. I do not think that the cases equate to each other. One is the purchase of a going concern, and the other is the resolution in a distressed situation.

Senator **Specter**. Which is the distressed situation?

Mr. **Mellon**. Well, Norfolk Southern is forced to sell these lines. They are not requesting to sell them. They are forced to sell them by the Department of Justice.

Senator **Specter**. So you think the acquisition of a going concern ought to bring more money than the sale in the distressed situation?

Mr. **Mellon**. I would say there are different values and the liabilities associated with a going concern may exceed the assets. I do not know. I have not looked at Conrail's recent figures.

Senator **Specter**. You are a railroader: Would you not like to buy 85 percent of Conrail for $1.2 billion given the assets of the company?

Mr. **Mellon**. Honestly, Senator Specter, we set the price. We bid on Conrail and that was our first bid price.

Senator **Specter**. You are responsible for that?

Mr. **Mellon**. Yes, sir. [Laughter.]

And I will tell you honestly, we were told at the time that we would be given one and only one chance to bid on it. And we had to come in with our best and final offer, which is what we did.

Senator SPECTER. Suppose you were given another chance to bid on it?

Mr. MELLON. Under what circumstances?

Senator SPECTER. Under circumstances that time has passed, it has made a lot of money, that some people in the U.S. Senate do not like the sale to Norfolk Southern, that S. 465, which I introduced, calling for blocking of the sale is enacted, on the ground that we are going out and looking for more bidders. Do you think you might bid $1.21 billion?

Mr. MELLON. Well, honestly under the current circumstances I would be obliged to stick with my deal with Norfolk Southern. I would not attempt to reenter the bidding. But if that entire process disappeared and you are talking about a hypothetical rebid, I would say this, that under the circumstances last year there were 15 active bidders and I think a large portion of them were serious bids, at least the majority of them. There were certainly a few flakes in there.

Senator SPECTER. Well, Conrail looks better now than it did a year ago, does it not, given its additional earning period?

Mr. MELLON. No, I would not agree with that.

Senator SPECTER. Do you think it looks worse?

Mr. MELLON. I think it is worth less than it was last year.

Senator SPECTER. So you would bid less than $1.2 billion?

Mr. MELLON. I did not say that. Our circumstances are different because we would bring synergistic values to the combination. This is the argument we made at the time, that the combination of the Guilford Railroads with Conrail added more than just the sum of the parts. Therefore, what we brought to it made it more valuable to us.

Senator SPECTER. Are you familiar with Morgan Stanley's testimony, that they feel they could bring $1.5 to $1.6 billion at a public stock offering for 85 percent of Conrail?

Mr. MELLON. I have not read that testimony directly, no.

Senator SPECTER. Would you have any judgment as to what a public offering would bring on Conrail?

Mr. MELLON. No, sir, I do not.

Senator SPECTER. Thank you very much, Mr. Mellon. Thank you very much, Mr. Neuenschwander. Mr. Chairman, thank you.

Senator MCCONNELL. Thank you, Senator Specter. Thank you, gentlemen.

The next witnesses in a panel are Bruce Wilson, vice president, law, Consolidated Rail Corp. of Philadelphia; John Snow, president and chief executive officer of the Chessie System Railroads, CSX Corp., Richmond; John H. Burdakin, president of Grand Trunk Western Railroad Co. of Detroit.

Senator Metzenbaum had to leave. He is going to be submitting questions in writing to you all that I would like you to submit answers to for the record. Also, as with the other witnesses, I hope you will try to confine your comments to no greater than 5 minutes each, and, if it is possible to do less than that, that would be terrific, and submit your full statements for the record. Who is first?

STATEMENTS OF BRUCE B. WILSON, VICE PRESIDENT, LAW, CONSOLIDATED RAIL CORP.; JOHN W. SNOW, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CHESSIE SYSTEM RAILROADS, CSX CORP.; AND, JOHN H. BURDAKIN, PRESIDENT, GRAND TRUNK WESTERN RAILROAD CO.

Mr. WILSON. I guess I am, Senator. My name is Bruce Wilson. I am Conrail's chief legal officer, and from 1971 to 1976 I had the privilege to serve as Deputy Assistant Attorney General in the Antitrust Division.

If I understood Mr. McGrath correctly this morning, he said that the process we were going through right now and the Department of Justice's review both of this transaction and of the divestitures which the Department is going to require is the same process that the Department goes through all the time.

I think I should point out that there is one big difference as to the consequences of the process that we are in right now. That is that, if the Department of Transportation bill passes, that is the end of it. Everything else the Justice Department does in the antitrust area is subject to review in the courts, but this will not be.

This afternoon, I would like to summarize my testimony and make two other points. First, I want to explain to you why we think that a public offering of Conrail stock is in the public interest and why we think it is a better way to return Conrail to the private sector than the Department of Transportation's plan.

And, second, I would like to raise some fundamental issues of national policy which seem to have been swept aside in the process so far, because we believe that this merger would spell the end to competition in the northeast-midwest rail market.

We think that a public offering is going to serve better our fundamental national economic policy of competition. It is going to preserve rather than eliminate competition among railroads, and that is going to be to the benefit of shippers.

We have become convinced that a public offering is a better way to yield maximum return to the Government since it avoids unnecessary tax revenue losses to the Treasury.

We believe it is a better way to preserve the existing service patterns in the northeast and midwest—a primary goal of the Department of Transportation—since it means that you will not have to redraw the railroad map and you will not have to introduce new but untried competitors in an attempt to replace the vigorous competition which exists today between us and Norfolk Southern. And we think it is a better way to preserve jobs in our region.

Now, you might ask why we do not simply accept DOT's opinion that the sale of Conrail to NS is the best way—the bird in the hand. We cannot accept that on the record made to date, and we think we have an obligation to voice our views about how Conrail should be returned to the private sector so that the public interest remains the primary concern.

It may turn out that Norfolk Southern could satisfy that criterion. But we do not know it today because the public offering alternative has not been fully explored and, in the process thus far conducted by DOT and the process by which they propose to conclude this transaction, it will not be fully explored.

At no time in that process has DOT demonstrated any willingness at all to part with its interest in Conrail by means of a public offering, and, as the chairman knows, if there is not a willing seller it is rather difficult to find willing buyers, someone who is willing to purchase that stock and assume the risk of a subsequent public offering.

But despite that difficulty we are working very hard on that alternative. We are making substantial progress because we and others with us believe that is a better way to sell Conrail.

That brings me to the second point I want to make today, and that is the lack of solid information which this process has produced so far. We know that we have here an extraordinary transaction. It is going to produce the biggest transportation company in the country. But the implications for the national transportation policy which relies so heavily on competition and which seeks to prevent undue concentration of market power have not been analyzed on this record or elsewhere.

We know that the combination is going to have a significantly adverse effect on competition. Justice concluded that after only its limited review. But forms of competition other than that which Justice looked at are also going to be affected—source competition, for example. I think it is significant that nowhere in the Justice letter of January 29 is source competition mentioned, even though less than 2 months later Justice filed its evidence in the Santa Fe-Southern Pacific merger proceeding. That document is a lot thicker than the letter they wrote on Conrail, and it is replete with references to source competition which would be lost in this merger.

But we do not have any information on source competition here because if Justice did look at it, it has not told anyone what it found.

So I suggest that this process was not the same. It is at least different if not unusual. Likewise, we have no information on whether the divestitures are going to work. I think I have to say that the goals which the Department of Transportation is seeking to accomplish—to return Conrail to the private sector and to get $1.2 billion for the Treasury—are worthy, and I agree with them both.

But I do not agree that they should be pursued as ends in themselves by subordinating or ignoring important public policy considerations in the area of transportation, competition, tax, and tax enforcement.

And at the end of all this, the Congress is being asked to grant an extraordinary remedy—antitrust immunity. That grant would be unprecedented, especially since it would not be preceded by any kind of full and open public hearing with the right of cross-examination, and the right to discovery, by which those important policy issues can be explored. Thank you, Mr. Chairman.

[Statement follows:]

STATEMENT OF
BRUCE B. WILSON, VICE PRESIDENT-LAW
CONSOLIDATED RAIL CORPORATION

BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
MARCH 27, 1985

Mr. Chairman, and Members of the Committee, good morning. My name is Bruce B. Wilson, I am Vice President-Law of Conrail. Before coming to Conrail, I was an antitrust lawyer, and I served as Deputy Assistant Attorney General in the Antitrust Division from 1971 to 1976. I appear before this Committee today both as an antitrust professional and as Conrail's chief legal officer.

From an economic, antitrust and regulatory perspective, the Department of Transportation's proposed sale of Conrail to the Norfolk Southern Corporation is an extraordinary transaction. Economically, it is extraordinary because it would create the largest transportation company in the world, with combined revenue of nearly $7 billion. This company would control a mega-railroad that will possess 50% or more of the Northeast/Midwest rail market for chemicals, grain, automobiles, metals, scrap, and auto parts.

It is of extraordinary antitrust concern, as well, because, as the Department of Justice concluded, absent limited divestitures of Conrail and NS property, it violates the standards of the Clayton Act and the Interstate Commerce Act. Despite this, DOT asks Congress to exempt the transaction from every municipal, state, and Federal law, including the antitrust laws, and to immunize it and its future implementation from judicial review permanently. DOT makes this request despite the fact that no independent administrative agency or court has scrutinized the transaction, and no opportunity has been accorded the public to assess and comment on its impact. The grant of immunity under these circumstances would be unprecedented.

Finally, the transaction is extraordinary because it undermines the important pro-competitive regulatory reforms of the Staggers Rail Act of 1980. This, too, would be accomplished without public hearing.

Because it is so extraordinary, the transaction requires more than the usual scrutiny to insure its conformance with the Nation's fundamental policies in favor of competition. To date, however, even the usual scrutiny accorded mergers has not been undertaken. I urge this Committee, which is uniquely qualified, to conduct the careful review that is required by the public interest.

The Department of Transportation, charged with formulating a plan for the sale of Conrail, reviewed the transaction from its perspective as a willing seller; but that review was made internally, without public scrutiny, and DOT's perspective as a seller is not necessarily that of a defender of competitive policy. No one contests the goal of returning Conrail to the private sector. But Congress should not allow itself to be blinded by DOT's enthusiasm for this particular proposal. DOT is selling not just a railroad but -- as I will endeavor to point out -- a fundamental change in antitrust and transportation policies. Congress must determine whether that change is in the public interest.

In the normal course, Congress might rely on the Antitrust Division to provide the necessary background and analytical information. But DOJ's review, at DOT's request, was made internally, and from the perspective of antitrust counselor to DOT as a seller, not from its usual perspective as an overseer of questionable private transactions. Similarly, Norfolk Southern's statement that it "is not buying lawsuits," is understandable as the position of an anxious buyer, but that hardly warrants forsaking an inquiry into the public interest in this transaction.

Independent review of the entire transaction is thus clearly required to determine whether it serves the national interest. Moreover, this Committee must decide whether immunity from antitrust and other judicial review will serve that interest.

The legislation proposed by DOT would have the merger "deemed approved by the (Interstate Commerce) Commission under Chapter 113 of Title 49, United State Code."

Behind those innocuous words is Section 11341 of the Interstate Commerce Act that says. "A (rail) carrier ... participating in (an) approved ... transaction is exempt from antitrust laws and from all other law, including state and municipal law, as necessary ...." (emphasis added). Immunity of this sort is most unusual, and when granted has always been premised on completion of a thorough and searching proceeding by the ICC. No such proceeding is contemplated here; yet DOT and NS contend that antitrust immunity is vital. If the merger is in the public interest and is free from antitrust risk, why is this extraordinary relief required?

DOT's answer appears to be that immunity is required because the Justice Department found that the merger, absent supposedly curative divestitures, would have "a significant, adverse effect on competition." This answer leads only to more questions. First, on the basis of DOJ's analysis, should not the opposite conclusion be reached -- that, given these risks, antitrust immunity should not be granted to the transaction. Second, since NS and DOT have agreed to divestitures that purportedly meet DOJ's concerns, why does immunity continue to be needed? The answer to these questions is that the likely adverse competitive effects of the sale go well beyond those identified by Justice. I want to identify some of these effects for the record.

There are three basic types of competition between Conrail and NS. First, there is parallel line competition between origins and destinations served by both carriers. This type of competition was the subject of DOJ's publicly released analysis which concluded that the transaction had serious anticompetitive consequences, requiring divestiture of Conrail and NS assets to other carriers. Second, there is competition at origins and destinations served by the two carriers for traffic which does not terminate or originate at jointly served points. Finally, there is what I call national market competition which arises when a shipper or receiver competes in a national market and requires the assistance of its local carrier to help it compete in those markets. These last two forms of competition were not addressed in DOJ's publicly disclosed analysis, but they are in some ways more important than the first in terms of their impact.

Parallel line competition between points now served by both carriers occurs in Illinois, Indiana, Maryland, Michigan, Missouri, New York, Ohio, Pennsylvania, and West Virginia. For example, Conrail and NS compete head-to-head for Chrysler's auto parts business. To win this business, Conrail operates a special train running between Chrysler plants in Michigan, stopping at each to pick up carloads of auto parts that are then moved to assembly plants in St. Louis. Conrail's special train completes the run in four to five days less time than the service provided by NS. Chrysler saves $1 million a year in reduced inventory costs alone, and the Conrail special train facilitates use of "just-in-time" manufacturing techniques. In February of this year, Chrysler recognized Conrail's innovative service with a special award. I question whether the incentive for this special service will still exist if Conrail is acquired by NS.

While DOJ studied head-to-head competition, it apparently ignored real movements of traffic, such as the one I have described, and it ignored offers by such affected parties as CSX for data related to actual point-to-point movements. Justice looked, instead, at competition within counties -- a questionable exercise, since traffic does not move in such patterns. However, even the effects on "county competition" were enough to lead Justice to conclude that, standing alone, the merger would violate every existing merger standard. To remedy these violations, the Department proposed a limited divestiture of certain Conrail and NS lines. Besides conflicting with Congress' 1981 mandate that Conrail be sold whole, the proposed divestitures are wholly inadequate as substitutes for the competition that will be lost.

Norfolk Southern and DOT propose to divest lines whose acquisition, rehabilitation, and maintenance will require tens of millions of dollars. The divested lines are to be acquired by Guilford Transportation Industries and the Pittsburgh and Lake Erie RR who, between them, lost $75 million over the last three years. Traffic density on the divested lines is low. In many cases, the lines carry less than one-twentieth of the traffic carried by competing lines retained by Conrail and NS. No estimates of the ability of Guilford and P&LE to attract new traffic have been provided; the fact is that the merger of Conrail and NS will likely divert traffic from P&LE and Guilford.

One cannot measure the vigor of railroad competition by looking at lines on a map. Low density lines are generally regarded as a drag upon, not a benefit to, a railroad. In this situation one could easily have imagined NS demanding that it be permitted to divest or abandon these low density lines as a condition of acquiring Conrail. Instead, NS is being permitted to merge the best of NS with the best of Conrail, ridding the system of its least desirable pieces, and at the same time realizing cash and tax benefits from the divestiture.

This Committee must look closely at what kind of competition will emerge from this process. I am submitting for the record an analysis that I hope will assist in that effort.

Even if the divestitures could do the job, they do not address the loss of origin and destination competition. This is a serious omission.

For instance, Conrail and NS often compete for the first leg of a movement ultimately destined to a point served by only one or the other of them. Chrysler again provides a good example because it puts up about $40 million of outbound auto parts business for bid every year or two. NS could take the traffic from origin to destination by itself. Conrail competes only on the first leg and must interchange the traffic with NS to get it to destination. It ought to be easy for NS to win that competition. But Conrail won it by offering better rates and better service. Shippers and consumers benefit from this type of competition, but the Justice Department failed to consider it.

The Justice Department also failed to look at the reverse situation -- when traffic originates at points served only by one carrier but is destined to points served by both. For example, a large Midwest power company purchases coal from producers located in different parts of the country and served by different railroads. Conrail offers an attractive rate for the low sulfur coal originating on its line in West Virginia to make it competitive with coal originated on the Chessie and the NS. Moreover, Conrail is building a new track into a new West Virginia mine so that it can make use of Conrail's rates and compete for the power company's business. Many people benefited from Conrail's actions: the coal mine in West Virginia, which would not have existed without Conrail's help; the utility, which pays less for its coal because it has companies competing for its business; and, of course, the consumers of electricity who pay less for it because Conrail and NS compete. The Justice Department didn't count this. Yet this competition, too, will disappear if Conrail does.

These two types of competition between Conrail and NS affected traffic worth more than half a billion dollars in 1984 alone.

Justice also failed to address the national market competition I spoke of earlier. An example may help to explain what I mean. To help Bethlehem Steel compete in the national steel market, Conrail has reduced its rates on inter-mill traffic in each of the last three years. These rate reductions are offered because it is in Conrail's interest to keep Bethlehem Steel competitive with steel producers served by other carriers like NS. A combined NS/Conrail system would control so much of the rail market for steel that it may be able to raise prices with impunity to the detriment of competition in other non-rail markets.

The proposed sale will eliminate another, more intangible, competitive benefit. The Justice Department's merger guidelines stress that the Department is "more likely to challenge a merger" if "the firm to be acquired has been an unusually disruptive and competitive influence in the market." Conrail is exactly that sort of unique competitive resource. Since its inception, Conrail has taken the lead in making the rail industry more competitive and responsive to shipper needs. In 1980, Conrail led the fight for the Staggers Act and ever since has been aggressive in its efforts to enhance the competition the Act sought to bring to the rail industry. In 1981, Conrail withdrew from the rate bureaus in which rates had been set collectively for over one hundred years. To this day, it remains the only railroad to have done so. In 1981, Conrail began its challenge to the "equalized joint rate" system under which every route between two points, regardless of cost or efficiency, is priced the same. Against the strenuous opposition of those who benefit from this anticompetitive scheme, Conrail has fought for the right to price its services independently and, therefore, competitively. Today, Conrail leads the industry in developing computer technology to facilitate such independent pricing.

These efforts benefit shippers directly. For example, in 1984, Conrail developed a program to blend low sulfur coal mined on lines it serves in West Virginia with high sulfur coal mined in Pennsylvania. This blending results in coal of a quality suitable for export. Conrail lowered the rates on the West Virginia coal so that it could bring it to Philadelphia, blend it with the Pennsylvania coal, and still be price competitive with export coal marketed by NS and Chessie. As a result, Conrail has created new markets for Pennsylvania and West Virginia coal. Because of these extra efforts, Conrail doesn't make as much money on this export coal traffic as NS makes on its export coal. But we helped our customers capture some of the export coal market. If Conrail and NS merge, the combined system would have little incentive to help Pennsylvania and West Virginia mines compete with NS' existing -- more lucrative -- export coal business.

In sum, the competition that exists today between Conrail and NS means billions of dollars to shippers and consumers. In addition, it means a lot to the industries involved in the examples I've used. Conrail helped Chrysler in its remarkable recovery; it's helping Bethlehem Steel; and it is helping to create jobs for depressed coal industries in West Virginia and Pennsylvania. These are real beneficiaries of the competition that would be lost in a Conrail/NS merger.

These and other facts have not previously been put on the record. This transaction has been insulated from the public scrutiny usually afforded by the merger procedures of the ICC (and judicial review of those procedures), or by independent judicial review under the Sherman and Clayton Acts. Absent full public disclosure of the facts and circumstances that underlie the transaction, followed by an evidentiary proceeding at which all affected parties are permitted to explore its impact on the public interest, it should not be allowed to go forward.

At a minimum, this transaction should not be granted immunity from the antitrust or any other laws. Were the proposed merger one between two industrial giants other than railroads, the Hart-Scott-Rodino procedures would govern. The standardized and extensive information demanded by that process permits advance Justice Department review and a decision on whether to challenge the proposed combination. Regardless of the Justice Department's decision, private parties retain the right to challenge the merger in the courts. Thus, the rights of private parties are preserved, and their important role in antitrust enforcement is protected.

Before a merger involving railroads can take place, the ICC would ordinarily evaluate whether it is in the public interest or would have an adverse effect on competition. To ensure that all affected parties can participate, Congress established public notice procedures, and the ICC requires public disclosure of detailed operational, financial and marketing information. There is a full, evidentiary hearing with opportunity for cross-examination. While the Departments of Transportation and Justice participate, their views are not conclusive. Reflecting the importance it attached to this process, Congress accorded the ICC fifteen months to conduct it, and called that "expedited." Even when the ICC reaches its decision, that decision is fully reviewable in the courts.

The procedure advocated by DOT in this case contrasts with the normal procedure in every respect. Here, the views of the public have neither been solicited nor considered. Granting antitrust immunity to a transaction is a rarity under any circumstances. Without a prior public hearing, it is unprecedented. And it is particularly improper in a transaction the size of this one.

The legislation before you would compound this error by immunizing the transaction from review in the future. While the legislation theoretically gives the Special Court jurisdiction over the transaction, a transaction specifically approved by Congress could hardly be overturned by that Court as failing to meet Congress' mandate. In fact, it would be virtually impossible to mount such a challenge, since the legislation fails to set forth standards for review, and gives no indication that the antitrust immunity permitting consummation of the merger would be withheld during the pendency of that review.

Finally, there is another important aspect of this transaction as to which the record is even more barren. The legislation would authorize a transaction that appears to seriously undermine the Staggers Act reforms of 1980. The merged Conrail/NS entity would be required to "maintain or reestablish" certain joint rates and through routes. Again, an innocuous phrase masks a highly controversial issue that is the subject of ongoing ICC proceedings and a major antitrust case. The bill for which Congress' approval is sought authorizes a transaction that apparently resurrects the equalized joint rate system that I referred to earlier and that once governed all rail ratemaking. That scheme was the antithesis of competition. Moreover, in order to maintain it, it was necessary for the railroads to agree on the rates to be applied. This required antitrust immunity. The elimination of equalized rates and collective ratemaking was at the heart of the pro-competitive reforms of the Staggers Act.

Breaking the equalized rate system is, as Congress recognized in 1980, the prerequisite to independent pricing. And independent pricing is the cornerstone of a deregulated industry. This Committee is well aware that rail deregulation remains controversial. But this legislation is not the appropriate vehicle for resolving that controversy.

Re-regulation may also result from the Justice Department requirement that the merged company provide access to other rail carriers (so that the latter may serve shippers located in markets they do not now reach) "on customary terms and conditions." Identifying and agreeing to charge a "customary" rate for competitive access, which will require antitrust immunity, raises important regulatory concerns. More fundamentally, competitive access, and the price to be paid for it, are subjects of debate at the ICC and elsewhere, and ought not be resolved here.

Some of these new regulatory requirements would be enforced by the Special Court. Others are committed to an arbitration process. Since the usual regulatory body -- the ICC -- already has jurisdiction over similar matters, the legislation will result in a triple-track regulatory scheme highly likely to yield inconsistent results. It will be very difficult to know what matters are to be enforced in which forum, and to which matters antitrust immunity will attach.

Let me conclude by showing you a map of two western rail carriers. They overlap to approximately the same degree as do Conrail and NS. They are of approximately the same size as Conrail and NS. A merger of the two lines would have similar anticompetitive consequences, in this instance affecting Texas, Oklahoma, Nebraska, Washington, Oregon, Utah, Illinois, and Kansas. That's about the same number of states as are affected by the Conrail/NS merger. Neither of the two roads on my map is in failing financial health. Indeed, both are quite profitable. Between them, they earned more, though not much more, than Conrail and NS. They are, of course, the Burlington Northern and Union Pacific Railroads. Would you permit them to merge without ICC hearings? Would you grant antitrust immunity to the transaction? Would you believe that divesting a few low-density lines to financially ailing regional carriers would cure it of its anticompetitive effects? Would you permit it to proceed without any more public scrutiny than has been given to this transaction?

If the answer to all of these questions is "No," as I suspect, I submit to you there is nothing different about the Conrail/NS transaction. It cries out for careful public scrutiny. I ask this Committee to begin that process.

CONRAIL

BRUCE B. WILSON
VICE PRESIDENT-LAW

April 12, 1985

The Honorable Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
SR 218 Russell Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed are responses to the questions contained in your letter of April 4, 1985, regarding the proposed sale of Conrail to the Norfolk Southern Corporation.

I appreciated the opportunity to appear before the Committee on March 27, and would be pleased to provide any other information that would be helpful.

Very truly yours,

Bruce B. Wilson

Bruce B. Wilson

CONSOLIDATED RAIL CORPORATION SIX PENN CENTER PLAZA PHILADELPHIA, PA 19103-2959

1. How many employees did Conrail have in 1976?

Conrail employment averaged 99,685 for all of 1976.

2. How many employees does it now have?

As of March 15, 1985, Conrail had 34,669 full-time employees (this figure is low due to seasonal furloughs). Conrail's employment averaged 39,044 for 1984. Conrail expects to have a 1985 average level of employment of 37,662.

3. Who funded labor protection payments to displaced employees?

The United States Government has funded all labor protection payments to displaced Conrail employees, either directly or by reimbursing Conrail.

4. How Many Conrail employees do you project will lose their jobs in 1985 and 1986 under current management's plans?

Conrail's current five-year outlook anticipates an employment level of 37,662 for 1985 -- a loss of 1,382 jobs from 1984. The five-year outlook projects an employee level of 34,426 in 1986 (this outlook includes a recession) -- a loss of 3,236 from 1985.

5. How many miles of track have you abandoned at Conrail? How many miles in the State of Pennsylvania?

When Conrail began operations in 1976, Congress imposed a moratorium on line abandonments for two years.[1] Thereafter, Conrail recognized that many miles of costly but little used track would have to be pruned from its system if Conrail were ever to achieve the profitability which Congress contemplated upon its creation. To do so, however, would have imposed significant costs on Conrail in the form of labor protection and involved extraordinarily burdensome and time-consuming ICC procedures. Accordingly, Conrail directed its efforts toward seeking the statutory change needed for a less costly, more expedited abandonment process.

In 1981, with the enactment of the Northeast Rail Service Act (NERSA), Congress made that process available, and Conrail designed an abandonment program intended to assure that costly and underutilized rail track could be eliminated without endangering vital rail service. This program has been extraordinarily successful.

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[1] 45 U.S.C. §744(g).

In the first phase of the NERSA abandonment program ("Window I"), which covered the remainder of 1981, Conrail filed for abandonment of 2,612 miles of line, reducing its physical plant by about 15%. As a result of this effort, Conrail expects to achieve permanent annual savings of $61.5 million, and avoid rehabilitation costs of $60 million more. Of the abandoned lines, 830 miles of track have been sold for continued rail service. Negotiations are ongoing for the sale of another 100 miles of track.

In recognition of the importance and success of the Window I effort, Congress has twice extended Conrail's NERSA abandonment authority. Under Window II, which lasted until October 1983, Conrail filed for abandonment of 1,513 additional miles of track, representing approximately 9% of its remaining physical plant. These abandonments resulted in additional annual savings of approximately $29 million, and avoided one-time rehabilitation costs of $41 million. Of the track filed for abandonment, 151 miles have already been sold for continued operation, and negotiations are ongoing for the sale of 279 additional miles.

Window III of NERSA is scheduled to expire in 1985. Under Window III, Conrail has so far filed for abandonment of only six additional miles of track. Negotiations are underway for the sale of these lines.

The Pennsylvania component of these figures is 1,174 miles filed for abandonment since 1981, with 263 miles thus far sold for continued rail service, and negotiations ongoing for 214 additional miles.

A careful market study preceded every one of these abandonments. The Window I and Window II abandonments resulted in a loss of only 1% in Conrail's 1980 car loadings and 1.4% of its 1983 revenues. More importantly, rail service has been preserved for approximately 70% of the total rail shipments potentially affected by the abandonments.

These results reflect an innovative, award-winning Conrail effort to assure that traffic would continue to move over the abandoned track, but do so profitably. Conrail worked closely with short-line carriers and other Class I railroads to sell the abandoned trackage and design future operating arrangements with its new owners. Conrail has sold approximately 750 miles of track to forty shortlines, including twenty-one that were newly created. For this effort, Modern Railroads magazine gave Conrail its "Golden Freight Car Award" in 1984, citing its "imaginative shortline marketing program" that "owes a good part of its success to Conrail's branchline abandonment program" which, in turn, has made abandonments and line sales "less threatening to shippers and communities."

Conrail is proud of its efforts in this area and of its Golden Freight Car Award. We are pleased to submit a copy of the Award to the Committee, and ask that it be made a part of the record in this proceeding.

6. According to the Department of Justice Merger Guidelines, the Department is more likely to challenge a merger where "the firm to be acquired has been an unusually disruptive and competitive influence in the market." Do you believe Conrail meets this criterion? Please explain.

Since its inception, Conrail has been a unique competitive force in the rail industry. For nearly 100 years, railroading has been steeped in historic practices -- even when those practices became counterproductive, anticompetitive, and a major cause of many railroads' financial collapse. As part of its effort to become financially self-sustaining, and with the tools granted it by the Staggers Rail Act of 1980, Conrail has taken a leading role among those who would move the rail industry into the deregulated era.

Conrail recognizes that the cornerstone of deregulation is competition and, as reflected in our nation's antitrust laws, independent pricing is the absolute prerequisite of competition. But until 1980, independent pricing was essentially unknown in the rail industry, which had for many years set its rates collectively and high enough to protect inefficient carriers and inefficient routes. By working through cartel-like groups called rate bureaus, railroads set all of their rates -- including their single-line rates -- collectively. Moreover, rate bureaus were used to enforce the "equalized joint rate" doctrine by which all rail rates between two given points (regardless of their cost or circuity) were priced the same. Conrail was an early and persistent supporter of legislation that would overturn this anticompetitive scheme, and in 1980 Congress recognized rate bureaus and equalized rates as principal causes of the financial plight of the railroads. Accordingly, the Staggers Act severely restricted the ability of railroads to set their rates collectively, and eased the rules for canceling and modifying joint rates.

In 1981, Conrail withdrew from the rate bureaus completely. It is still the only major railroad in the country to have done so. This action effectively ended most cartelized ratemaking, since the absence of Conrail from the collective process required the other railroads to compete with Conrail on the basis of price.

At the same time, Conrail began its long (and ongoing) struggle to win the right to price its part of multi-carrier services independently. This action initially was opposed by virtually every other railroad. But Conrail was able to demonstrate that by pricing each route independently, in the light of its costs and its relative efficiency, traffic could be consolidated on the best routes, lowering the unit cost of service and making it possible to offer lower rates to shippers.

Railroads with inefficient routes, or who otherwise profited from the equalization scheme, continue to object to Conrail's right to price its own services without seeking their consent. But independent pricing has attracted new, price-sensitive traffic, reduced operating costs, and helped Conrail to win traffic back from other modes. This marketplace success has persuaded other railroads also to seek to price their services independently.

Today, Conrail is pioneering the technological effort to make independent pricing simpler and more efficient. Working with an independent computer firm, Conrail developed a computerized ratemaking plan that allows railroads to set their rates faster, reduces the number of errors, makes a wider range of rates more easily available to shippers, and allows rates to be changed quickly in response to competitive pressure. Other railroads were initially dubious, but because Conrail was willing to devote substantial time and money to develop a workable system, others are also adopting computer age pricing technology.

As late as 1984, twenty-six of the country's twenty-nine Class I railroads asked the ICC (and later the U.S. Court of Appeals for the Second Circuit) to allow collective ratemaking to continue in effect for inflation-related cost increases. Recognizing that all rate changes must reflect competitive conditions, Conrail opposed this request, and developed a fast and efficient means for railroads -- acting independently -- to seek and receive one another's concurrence in raising multi-carrier rates to recoup cost increases. When some carriers continued to resist, Conrail and others sought and received a Justice Department Business Review Letter allowing the plan to be implemented without antitrust risk. Only two other railroads joined Conrail in its successful opposition to the efforts of the rest of the industry to get the federal courts to allow continued collective ratemaking.

Conrail has fought alone for other forms of deregulation, as well. For example, in an effort to save the boxcar from virtual extinction because of its regulation-induced high costs and equalized joint rates, Conrail successfully petitioned the ICC for boxcar deregulation. Although actively opposed by most other railroads, Conrail proved to the ICC that only through deregulation could boxcar costs -- and rates -- be reduced, and the boxcar returned to use after a twenty-year decline. Partial boxcar deregulation has been in effect for nearly two years, and even though subject to constant legal challenge, its benefits are now widely apparent.

Numerous other examples could be cited, including Conrail's recent agreement with the Chlorine Institute on rules to resolve future joint rate and switching disputes, which, for the first time, applies the pro-competitive principles of the antitrust laws to rail ratemaking practices.

The common thread in each of these examples is Conrail's belief that it can survive and prosper in a competitive world and its willingness to fight for the right to put this belief into practice. This faith in the competitive process has shown results -- most obviously a $500 million profit in 1984. These results have convinced other railroads to follow our lead.

An independent Conrail will continue to play this leadership role, which we believe is vital to the success of deregulation.

Senator McCONNELL. Thank you, Mr. Wilson. Mr. Snow, are you next?

STATEMENT OF JOHN W. SNOW

Mr. SNOW. Thank you, Mr. Chairman. There has been a lot of talk today about the anticompetitive effects of this merger, and it seems to me that it is hard to overstate the anticompetitive consequences of Norfolk Southern-Conrail. It is a merger of unprecedented scope and scale, which would produce the largest, most market-dominant railroad in the history of the country.

It is a merger which would have enormous consequences to the States of Ohio, Indiana, and Michigan, where Norfolk Southern would become literally the dominant railroad. The effects are not limited to the Midwest and to the industries of the Midwest like chemical and coal and steel, but spread to the South.

The Chairman, Senator Thurmond, just returned; it has enormous effects on his State of South Carolina because, once Norfolk Southern and Conrail are put together, the enormous market power that that creates will be used to squeeze the other railroads out of the routings. So the traffic that today is available to those railroads to move to the South, to move to the West, and to move into Conrail territory, will be lost to them.

That traffic will not be lost on the basis of efficiency. It will be lost on the basis of raw market power. The effects on my company, CSX Railroads, Chessie, and Seaboard, will be literally devestating. Mr. McGrath today said an assumption for the antitrust analysis was the existence of three competitors.

Mr. Chairman, let me assure you that the B&O Railroad cannot survive if NS-Conrail is allowed to go into effect. And if the B&O Railroad cannot survive, then there will not be three competitors; there will be one competitor.

I have observed antitrust analysis for a number of years including back in the days when Mr. Wilson was heading the Division, and I have never seen an antitrust analysis of the sort that was conducted in this proceeding. It totally overlooks traditional standards. It overlooks source competition. It does not apply the Herfindahl indices. It relies on anonymous shippers' statements from big shippers as if all shippers are big shippers and as if all shippers are in a position to protect their interests as well as big shippers.

Also, and most fundamentally, it totally overlooks the enormous market power that will come to Norfolk Southern once it is married to Conrail, the power to squeeze Grand Trunk Western, CSX, ICG, Chicago Northwestern, and the other carriers that are essential to competition in the region out of the routings. And once they are gone from the routings, Mr. Chairman, you have sounded the death knell of competition in the region and you have invited reregulation of the railroad industry.

The foundation of the Staggers Act, which is a kind of Magna Carta of deregulation for the railroad industry, is premised on an effectively competitive-structured railroad industry. That effectively will be gone.

There is an alternative, and that is the public offering, which Mr. Wilson mentioned. It is a proposal which we are working hard on. It avoids all of the consequences of the—the anticompetitive consequences which have been discussed here today. And we feel it will return Conrail to the private sector as it should be returned with the same solid, hard cash or more than the Norfolk Southern offer does and it will do so without the risk that the taxpayers will get less money, without the risk that the United States Treasury will be a minority shareholder. And we would only ask that it be given an opportunity.

Finally, let me comment on the antitrust antidote, the minicarriers who will come into being to police the giant Conrail-NS. It is a fanciful notion, at best. It borders on the absurd to think that these struggling carriers with hand-me-down lines can provide effective competition to the largest, most market-dominant railroad in the history of the world.

Rather than providing effective competition, these minicarriers will be entering into a state of economic serfdom. They will live at the sufferance of Norfolk Southern/Conrail. They will not be able to provide effective competition. It is preposterous to think that the P&LE and Guilford, their size and with the routes they will be taking and with their cash-flow problems and with their negative working capital can provide anything approaching the effective, head-to-head competition which NS and Conrail provide for each other today.

Mr. Chairman, the consequences for your State of South Carolina, Senator McConnell, for your State are enormous. Let me just close by saying that you asked the question on coal; the effects on coal would be enormously significant. Great amounts of coal will be displaced as Chessie is foreclosed from taking Kentucky and West Virginia coal up to the Northeast powerplants that are on the Conrail lines. I thank you.

[Prepared statement and responses to the chairman's written questions follows:]

Testimony of John W. Snow,
President and Chief Executive Officer of
Chessie System Railroads

My name is John W. Snow, and I am the President and Chief Executive Officer of Chessie System Railroads. I am here today on behalf of the CSX railroads -- the Chessie and Seaboard systems -- and our parent company, CSX Corporation, to explain our opposition to the proposed sale of Conrail to the Norfolk Southern Corporation.

A sale of Conrail to Norfolk Southern would be the most anticompetitive combination ever proposed in the history of the transportation industry. It would destroy the foundation for our nation's competitive rail system in the Northeast, and would also have severe adverse consequences in the South and West. If such a sale were allowed, CSX would have to totally restructure its operations in the Northeast. We would be forced to abandon 4000 miles of railroad and to release 4,000 or more employees. I say this not in anger or as a threat but, as our Chairman says, simply as a matter of economic reality.

A combination of this magnitude will threaten the railroad reforms that Congress initiated in the Staggers Act. That statute has had many beneficial effects, but it is premised on the idea that competition will be a viable substitute for regulation. A Norfolk Southern-Conrail combination, however, will eliminate that competition, and will do so throughout enormous regions of the country. Nor will competition be preserved by the Justice Department's amazing divestiture proposal, which has no genuine prospect for success and appears to be nothing more than a convenient vehicle to allow the Department to reach a predetermined result.

Let me begin by telling you something about CSX and putting in perspective certain comments that were made about CSX when we last testified -- before the Commerce Committee -- on the Conrail proposal.

Background of the CSX System

CSX is the product of mergers, but it is not the product of a merger like the proposed Norfolk Southern-Conrail merger.

CSX was formed in 1980 in connection with the merger of the Chessie System and Seaboard Coast Line Industries. Both companies, of course, were railroad holding companies and, as the result of the merger, CSX is the owner of a large railroad system -- though one that is, as I shall detail, nowhere near as large as a combined NS-Conrail would be. In 1984, we also acquired a barge company, American Commercial Lines. Thus, we are a large company in the transportation business and we have been involved in two significant mergers in the past five years.

Some people seem to think that because we are large and because we were involved in two recent mergers, we should support all mergers of any size and that it is somehow inconsistent for us to oppose a merger of Conrail and Norfolk Southern. It has also been suggested our opposition to the Norfolk Southern proposal arises simply because we are "afraid of competition."

We are not afraid of competition, or of mergers by our competitors under fair standards and procedures. We have stood foursquare for competition and deregulation in the rail industry as a whole, and we actively supported NERSA, which helped Conrail to become more competitive. We believe transportation mergers, in many cases, can allow for more efficient operations and better service without having any significant adverse impact on competition. This can occur when the merging companies are not substantial competitors and adequate competition remains post-merger. We have not opposed these kinds of mergers. CSX, for example, did not oppose the merger of the Norfolk & Western Railroad and the Southern Railway

System -- even though it united two of our most vigorous competitors into a single, and far more vigorous, competitor.

Neither the two CSX mergers that I mentioned, nor the Norfolk Southern merger, involved companies that were in substantial competition with one another. If you will look at an old railroad map, you will see that the Seaboard railroads operated primarily in the South, and to the western gateways: to New Orleans, Memphis, and East St. Louis, on the Mississippi, and to Chicago. Its lines in the east came no farther north than Potomac Yard in Washington, D.C. -- which it reached only through a partially owned affiliate, the Richmond, Fredericksburg and Potomac -- and it had no significant operations in Ohio, West Virginia, Pennsylvania, Maryland or Delaware.

The lines of the Chessie railroads, by contrast, covered the middle Atlantic region with principal lines running east-west from Norfolk and Newport News, Baltimore and Philadelphia through Pennsylvania, Maryland, Virginia and West Virginia to western connections in Ohio, Indiana and Illinois. Although the Seaboard railroads competed head-to-head with the Southern Railway System, there was little, if any, competition between Seaboard and Chessie.

The Interstate Commerce Commission held a full hearing on the Seaboard-Chessie merger and that was the conclusion that it reached after carefully considering the matter. Here is what the ICC's report said: "Because of the efficiencies that are possible under the new system, CSX carriers will be able to provide greater intermodal competition in north-south transportation. The consolidation will not tend to lessen substantially transportation competition in any relevant market." The Departments of Justice and Transportation also reviewed the Seaboard-Chessie merger, and they reached the same conclusion. There was never any finding that this merger was anticompetitive, much less was there any conclusion that divestitures were necessary, or that new rail systems had to be created, to remedy the anticompetitive effects of the merger. Moreover, the Seaboard-Chessie merger was subject to an open, and public, review process with opportunity for full participation by all affected parties.

Nor was there any substantial competition between the Southern Railway System and the Norfolk & Western. Like Seaboard, the Southern Railway System operated primarily in the south, with principal lines in states such as Alabama, Georgia, North and South Carolina and Virginia. Like Seaboard, Southern went west to New Orleans, Memphis and East St. Louis but, in the east, no farther north than Potomac Yard in Washington. Like Chessie, the N&W was essentially an east-west carrier operating north of Washington in Delaware, Maryland, West Virginia, Pennsylvania and Ohio. The ICC had no qualms about the Norfolk Southern merger. As it noted in its report: "The NS consolidation enhances competition. Indeed, the record before us would not permit any other conclusion." As in the CSX merger, the Departments of Justice and Transportation also found that the NS merger was not anticompetitive.

In the case of American Commercial Lines, there was, again, no adverse impact on competition. The pre-merger relationship of the CSX railroads and American Commercial Lines was largely end-to-end, with the railroads delivering a small amount of bulk traffic for movement onward by barge. The ICC also held a full hearing on this merger. As it noted in its decision there were "literally hundreds of [barge] firms handling traffic" in the relevant market, and there was great ease of entry into the market. As one who participated in the ICC's hearing, I can say that there was never a question whether there would be one or two surviving competitors. The only question was whether there would be dozens, hundreds or thousands of competitors. The ICC's conclusion in this case was the same as it was in the other cases I have described: that "the transaction will not result in a substantial lessening of competition in freight surface transportation in any region of the United States."

These, in other words, were beneficial mergers, between companies that were not in substantial competition with each other and where after the merger there was substantial competition. And they were confirmed as such on the basis of full and open public hearings on an evidentiary record before an independent agency with full opportunity for cross-examination, rebuttal evidence and judicial review.

A Norfolk Southern-Conrail Combination Will Eliminate Competition

The combination of Conrail and Norfolk Southern is a horse of a different color entirely. This would be an overlapping merger between two railroads that substantially compete with one another. Moreover, one of the railroads -- Conrail -- already has an extensive monopoly in the Northeast, which the combination will further extend to the South and the West. This merger, quite simply, will obliterate competition in the Northeast.

The existing competition between Conrail and Norfolk Southern is not theoretical or incidental. These are substantially parallel railroads that compete head-to-head throughout an area of roughly 100,000 square miles running from Buffalo and Pittsburgh in the East to St. Louis and Chicago in the Midwest. This region of head-to-head NS/Conrail competition includes all or parts of the states of New York, Pennsylvania, Ohio, West Virginia, Kentucky, Michigan, Indiana and Illinois. It is an area that still contains much of our nation's heavy industry, and is vitally dependent on rail transport. The sale of Conrail to Norfolk Southern will devastate the direct competition between NS and Conrail through this region.

The combination will have negative impacts throughout the economy. Transportation of steel, autos, chemicals, coal, machinery, paper, construction materials and many other commodities, including grain and other farm related items, will be negatively affected. On many routes where NS and Conrail now compete traffic is well divided and competition between the two railroads is strong. The total rail traffic moving between Fort Wayne, Indiana and Detroit, for example, is now split 64-36% between NS and Conrail; between Lafayette, Indiana and Cleveland the figures are 43-57%; between Columbus, Ohio and Youngstown, 37-63%. On these routes, and dozens like them, competition will be totally eliminated. Indeed, a total of more than 200 million tons of rail traffic in more than 200 counties will be deprived of the benefits of significant rail competition. The anticompetitive consequences are truly staggering.

But a sale of Conrail to Norfolk Southern will not only eliminate the substantial direct competition between the two railroads. It will also allow Norfolk Southern to extend Conrail's near monopoly in Pennsylvania, New York and New Jersey far beyond these states, into the South and to the West as well. Conrail's present Pennsylvania, New Jersey and New York monopoly, I should note, was created not as a matter of choice but only as a matter of last resort or desperation. In early stages of the rail problems in the Northeast, the Department of Justice, in a position remarkably different from its present position, had opposed the affiliation of the Pennsylvania Railroad with the N&W on the ground that such a combination would have been anticompetitive. At the time of the bankruptcy of

Conrail's predecessors, many -- including, I should note, the Department of Justice, again, and Congress itself -- favored a plan that would have preserved competition by providing for service to the Northeast by several railroads. The plan failed as a result of a labor stalemate, and the only available alternative was to allow a monopoly -- the so-called "Big Conrail." There was no idea that the monopoly would ultimately be transferred to a large, and profitable, private railroad that could use it for competitive leverage in other regions.

Yet once Norfolk Southern and Conrail are put together, any rail shipment originating in Conrail's existing monopoly areas, which is destined beyond Conrail's present lines, will go all the way, as far as it can go, on the combined Norfolk Southern-Conrail system. This will occur because NS-Conrail will eliminate or reduce the availability of the joint, or interline, service that currently allows for competition with the NS system on traffic from Conrail's territory. For example, shippers that currently send freight from New York City to Atlanta must use Conrail for the first leg of their shipments -- usually New York to Potomac Yard outside Washington, D.C. For the Washington to Atlanta leg of the shipments, the shippers currently can secure competing bids from NS and CSX. That competition restrains the charges for shipments from Washington to Atlanta, and thus restrains the overall freight charges from New York City to Atlanta. However, after the sale of Conrail to Norfolk Southern, interline competition between NS-CR, on the one hand, and CR and connections of CR in competition with NS, on the other, will dry up.

Railroads traditionally seek to route traffic over their long-haul routes. As long as competitive alternatives are available, this practice is generally desirable, and benefits shippers. But where one system controls both the origin and the destination of the traffic, the results are extremely harmful. A railroad with that kind of control gains a dominant position over customers and competing railroads too. A combined NS-Conrail will have that position in respect to an enormous amount of traffic.

A combined NS-Conrail system will rewrite the rail tariffs -- just as the NS railroads and Conrail individually already have rewritten their tariffs -- to provide that where NS-Conrail can handle a movement entirely on its lines, no realistic alternative to NS-Conrail transportation will be offered; also, that wherever NS-Conrail is the only carrier available to handle either the origin or the termination service, the traffic will be routed over the longest available NS-Conrail systemwide haul or, at a minimum, will be confined to NS-Conrail and another railroad whose participation is physically indispensable to the movement. The result will be to deprive shippers, throughout the vast area to be served by the combined NS-Conrail system, of any meaningful competition for their rail movements. Only those shippers open to competitive rail service at both the origin and destination points of their movements will be able to avoid the monopolizing grip of the NS-Conrail combination.

The monopoly extension effects of an NS-Conrail combination will be felt throughout the South. For example, in 1983, Conrail was involved in joint line movements to and from South Carolina that accounted for approximately 1.4 million tons of traffic moving between South Carolina points and locations in fifteen northeast and midwest states where Conrail is either the sole or the dominant rail carrier. On such traffic, South Carolina shippers currently benefit from competition between CSX and Norfolk Southern in 21 South Carolina counties which, together, account for two-thirds of the state's total rail tonnage. After an NS-Conrail combination, shippers in all of these 21 counties will lose the competitive CSX service to and from all Conrail points.

Shippers and competing railroads in the West will also suffer from the monopoly extension. Previously, movements from the monopoly area in New York, New Jersey, and Pennsylvania to the West would be interchanged by Conrail at Chicago or St. Louis with western carriers. But Norfolk Southern's system does not end at Chicago or St. Louis; it crosses the Mississippi and goes to Kansas City. The western carriers are going to see traffic diversion on all long-haul movements west originating on Conrail. We have estimated, for example, that roughly one-half of the revenue derived by each of the ICG, the C&NW and the Missouri Pacific from traffic interchanged with Conrail may be lost as a result of an NS-Conrail combination. Shippers in the West will be hurt as well. Like the shippers in the South, western shippers will find their competitive routing and gateway alternatives foreclosed.

In terms of specific commodities, the combination will have a particularly severe impact on coal traffic. Let me explain how this will occur. Conrail provides the only rail service to 39 utility power plants in its operating territory. Conrail does not have enough coal on its own lines to supply all these plants and it has cooperated with the utilities in their efforts to obtain competitive sources of coal supply. Under the present system, those utilities have a choice of various sources from which to purchase their coal. A utility can, for example, purchase coal from a mine served by CSX (such as one of the many West Virginia mines served by the Chessie System), and have the coal delivered over a joint CSX-Conrail route. Or the utility can purchase coal from a mine on the NS, and have the coal delivered over a joint NS-Conrail route. This choice gives the utility bargaining power.

Once Conrail and NS are combined, this choice will disappear. NS will, as I have explained, adjust Conrail's rates to foreclose a joint CSX-CR movement. The combined NS-Conrail movement will be the only realistic alternative offered. Not only will we lose our chance to bid for the coal traffic, but the utilities will be restricted in their choice of coal sources and the coal shippers -- at least those that are on our lines -- will be hurt as well. Over time, we will be forced out of the business, and NS-Conrail will become a dominant, indeed monopoly, carrier.

And this is not merely a matter of economic theory, but a matter of fact. Attached to this testimony is an article from the Wall Street Journal of April 25, 1983 explaining exactly how a utility was able to use an alternative source of supply in order to obtain a "competitive rate structure" for West Virginia coal. As the article explains, the availability of coal from mines located on Conrail forced NS to lower its price for hauling West Virginia coal. Of course, this would not have happened without an independent Conrail.

NS has attempted to diffuse objections from coal users, suppliers and ports by suggesting such things as that an NS-Conrail combination will, somehow, allow for an increase in coal traffic from mines on the NS lines to the port of Philadelphia. Mr. Claytor has said that NS-Conrail "will be able to increase business at Pier 124 in Philadelphia because we can mix low sulphur coal from mines on Norfolk Southern lines with higher sulphur coal on Conrail lines." But most of the coal mines on the NS system are in Virginia, West Virginia and Kentucky. The only logical port for this traffic is the port of Norfolk, where the traffic now goes and where it surely will continue to go after a combination of NS and Conrail. Philadelphia will not see it.

The fact is that although this merger will divert coal shipments to the NS-Conrail lines, it cannot possibly increase shipments of coal. Its only possible overall impact on coal traffic will be to allow the combined NS-Conrail -- sooner or later -- to raise shipping rates and, therefore, to make coal a less competitive and attractive source of energy. The effect on other commodities will be similar.

Even the Justice Department found that the merger would have anticompetitive effects. But because it did not properly and completely analyze those anticompetitive effects, it proposed a solution which was no solution at all. I will come back to this later.

The NS-Conrail Combination Is To Be Exempted from Traditional Public Interest Review

While the CSX, and N&W-Southern mergers that I described earlier were tested in plenary administrative proceedings before the ICC involving submission of detailed evidence and opportunity for cross-examination, with judicial review also available, the NS-Conrail combination is to be immunized from any form of impartial public interest scrutiny. This transaction was formulated on the basis of closed negotiations between Norfolk Southern and the Department of Transportation. CSX's involvement in this process has principally involved writing a series of letters, to which we have received no reply.

Moreover, even though no public participation was allowed in the period prior to the announcement of the sale, the plan is to preclude meaningful scrutiny subsequent to the sale as well. To this end, the enabling legislation submitted by Secretary Dole provides that the transaction is to be immunized completely from administrative consideration on the record -- whether on antitrust, or any other, grounds. Ordinarily, a rail merger of this magnitude would be subject to an exhaustive review by the ICC in an adversary proceeding, taking many months and involving submission of detailed evidence, cross-examination of witnesses, thorough briefing and the availability of judicial review. Not here. Here both the sale itself, and also the "coordinated operation of [Conrail's] properties with those of Norfolk Southern Corporation and its affiliates as a single rail system" are to be "deemed approved" by the ICC even though they have not been so approved and are not to be so approved. The purpose of this is to ensure that the Norfolk Southern/Conrail combination will enjoy the antitrust immunity that a merger that has survived ICC review and judicial review has under the law. Moreover, no judicial review will be available -- even though it would be in the case of a merger actually approved on the record by the ICC -- because the proposed law forbids it. The transaction also is to be exempted from the Administrative Procedure Act, the Government in the Sunshine Act and a host of other public interest laws.

In other words, the procedures proposed for this transaction are as shocking and palpably contrary to the public interest as is the substance of the proposed deal.

A Norfolk Southern-Conrail Combination Will Destroy the Existing Competitive Balance

Another comment we have heard in recent weeks is that the NS/Conrail combination is necessary to restore, or promote, competitive balance between Norfolk Southern and CSX. For example, we have heard Mr. Claytor of NS argue that Norfolk Southern's lines do not go north of Washington or east of Pittsburgh and Buffalo, and that the acquisition of Conrail is needed to place NS on an equal competitive footing with CSX.

Let me put the issue of competitive balance in perspective.

CSX has a single line running from Potomac Yard in Washington to Philadelphia, and no farther. And we have a rather crooked B&O line that runs from Pittsburgh to Buffalo with a branch from Ashford, New York to Rochester. That is all we have in those areas. Conrail, by contrast, blankets not only Pennsylvania but New Jersey and New York as well. In Pennsylvania, its lines run west from Philadelphia to Reading and Harrisburg to Pittsburgh, as well as north to, among other points, Williamsport and Scranton. And it has lines in New York running from New York City to Albany and east through Utica, Syracuse, and Rochester to Buffalo, with an extensive network of additional lines running north, south, east and west of these areas, and to New England. I think you will agree with me that it is irresponsible to suggest that it is somehow necessary to sell all of Conrail to Norfolk Southern in order to compensate for our lines to Philadelphia, Buffalo and Rochester -- which are virtually the only segments of the CSX system in the Northeast that are not substantially duplicated or paralleled by NS lines.

The fact is that the CSX and Norfolk Southern railroad systems already are remarkably well balanced. Throughout virtually the entirety of their service areas, the lines of the two railroads overlap each other. They serve most of the same markets and most of the same major cities. If anything, as the competitive balance now exists, NS has an advantage over CSX. While CSX does not go west of the Mississippi River, NS goes 250 miles beyond the Mississippi to the Missouri -- to Kansas City. Moreover, although CSX has more absolute miles of track, NS already has the higher density, higher profitability routes -- as evidenced by the fact that their profits exceed ours even though their revenues are less.

With the substantial balance between NS and CSX, and with Conrail's new competitive strength, the eastern part of our country now has the benefit of service by three competitors of roughly equivalent strength and staying power. Again, if anything, the advantage does not lie with CSX but with its competitors, NS and Conrail. In 1984, for example, the net railway operating income for the northeast rail operations of the three companies was as follows:

	1984 (in millions)
CR	$ 422
NS (N&W)	$ 168
CSX (B&O and C&O)	$ 149

Let us see what these figures mean as to rail profits in the northeastern area of the United States -- the area in which the Norfolk and Western, the Chessie System and Conrail now operate. What happens if we put Norfolk Southern and Conrail together? Secretary Dole says that Conrail's "normalized" profits for 1984 -- if it had not had the advantages of government ownership, such as the state tax exemption, freedom from labor protection payments and the concessionary labor rate -- would have been $290 million. The Norfolk and Western net operating rail income was $168 million for 1984. If you put Norfolk and Western and Conrail together, accordingly, you have $458 million in net railway operating income. The net railway operating income of the Chessie System (the C&O and B&O) was only $149 million for that year.

This means that a combined Norfolk and Western/Conrail would have three times the net rail operating income of the Chessie System. This does not take into account the savings from the combination of Norfolk and Western and Conrail. And, of course, it does not take into account the deterioration of the Chessie System's gross revenues -- and ultimately its net rail operating income -- that would ensue upon the combination. Balanced competition in the area where the three systems now compete would be a thing of the past. The three to one imbalance would only get worse.

Furthermore, even the net railway operating incomes for all rail operations of the three companies -- including operations in the South -- still show Conrail with a significant advantage:

	1984 (in millions)
Conrail	$ 422
CSX	$ 414
Norfolk Southern	$ 396

And the profits of the three companies from all sources -- while reflecting a rough parity -- also show CSX at a disadvantage, and give no suggestion whatever of a need to redress any imbalance in CSX's favor, let alone combine two of the three against CSX:

	1984 (in millions)
Conrail	$ 500
Norfolk Southern	$ 482
CSX	$ 465

(These numbers, I should note, are numbers that do not reflect the diversion of traffic from CSX to NS-Conrail that will occur after an NS-Conrail combination.)

Far from promoting competitive balance, Norfolk Southern's proposed absorption of Conrail would clearly destroy it. A Norfolk Southern-Conrail combination would be a railroad colossus. It would have two-thirds of rail revenues and one-half of rail tonnage in the Northeast. It would have more locomotives, over 6,000, more freight cars, over 240,000, and more miles of road, over 34,000, than its closest rival . . . CSX.

The Divestiture Scheme Will Not Preserve Competition

As I mentioned and you well know, the Department of Justice has done an antitrust analysis of the sale. In our view, the analysis significantly understates -- and in some respects ignores -- the anticompetitive impacts of the sale. The Department for several years now has used a formula for measuring pre- and post-merger market shares of companies planning to merge. The formula is known as the Herfindahl-Hirschman index -- "HHI" -- and it is reflected in the Merger Guidelines that the Department first issued in 1981 and reissued just last year. The Department regularly applies HHI to all kinds of merger cases. Inexplicably, however, the Department made no use of HHI in analyzing the NS-Conrail merger. It didn't even mention HHI. Yet, if one applies HHI to, for example, Washtenaw County in Michigan -- where Ypsilanti and Ann Arbor are located -- the NS-Conrail combination fails the analysis. Even assuming that it is reasonable to look only at traffic originating or terminating in a county, as the Justice Department has done in its analysis, Conrail now terminates 61% of the rail tonnage in Washtenaw and NS terminates 39%. Under a Herfindahl analysis, their post-merger figures produce an HHI number of 10,000, an increase of 4758 points and the maximum possible HHI number -- one which would ordinarily preclude the merger of two companies under the Department of Justice's guidelines.

Nor did the Department use the kind of point pair analysis that both it and the ICC have traditionally used in analyzing the impact of rail mergers. This analysis, logically enough, requires consideration of actual flows of traffic between and among geographic points as the measure of railroad market share. But the Department performed no such analysis. Instead, it limited itself -- again, inexplicably -- to consideration of traffic flows to particular locations and traffic flows from particular locations while making no attempt to correlate the two and no attempt to measure the true scope of the competitive foreclosure involved.

Furthermore, the Department departed again from traditional approaches by taking the extraordinary view that antitrust concerns that might otherwise exist could be overlooked in any market in which the "major shipper" expressed no objection to the NS-Conrail combination. These markets were excluded from the analysis, even though the "major shipper" in any market usually will have alternative sources of supply, or other forms of competitive and retaliatory leverage, that will be unavailable to smaller shippers, who must be dependent on competition between railroads as the basis for obtaining good service and reasonable rates.

(There is also a question, I should note, of just how accurately Justice was able to determine the views of shippers without an open public hearing -- which, of course, it did not hold. While Justice has not disclosed the identities of the shippers that it contacted, NS has released a list of shippers who, according to NS, support an NS-Conrail combination. In our contacts with over 1000 of those shippers, literally hundreds of them have denied expressing support for NS-Conrail. We have concluded that only a small percentage, in fact, support an NS-Conrail combination. At the same time, many shippers -- including "major shippers" -- have publicly expressed their opposition to the NS-Conrail combination in the strongest possible terms.)

Finally, the Department ignored completely not only the elimination of source competition but also the monopoly extension aspects of an NS-Conrail combination. As I have explained, the combination will eliminate source competition for coal and other commodities, and will result not only in perpetuation of the Northeast monopoly but in foreclosure of competition to the farthest limits of the NS system -- to Chicago, Des Moines, Kansas City, St. Louis, Memphis, New Orleans and Jacksonville. The Department apparently didn't think these aspects of the problem were even worth noting.

Given the magnitude of the competitive problems with an NS-Conrail combination, it is not surprising that even the Department's highly unusual, and limited, analysis still resulted in the conclusion that a Norfolk Southern-Conrail merger would "have a significant adverse effect on competition for the transport of commodities to and from a number of locations in several states." The Department found that: "Without appropriate divestitures, the proposed merger would violate both Clayton Act and Interstate Commerce Act merger review standards."

While the scope of the proposed "appropriate divestitures" was unclear at the time the Justice Department performed its review, we are now told that the divestitures will involve trackage or trackage rights to be provided to Guilford Transportation Industries and to the Pittsburgh and Lake Erie Railroad.

Let me say a few words about this most remarkable aspect of the proposal.

Guilford and P&LE are tiny railroads. The Guilford system, ranked 16th among Class I railroads, has three lines, the Boston & Maine, the Maine Central and the Delaware & Hudson. The Boston & Maine and the Delaware & Hudson have been financially distressed for many years and the Maine Central, which is a Class II railroad, has been only modestly profitable. In the years 1981-83, the Guilford railroads together had net losses of some

$36 million. In 1984, they made a profit of about $1 million.

The Guilford system will be dwarfed by the proposed Norfolk Southern-Conrail combination. Norfolk Southern and Conrail have about 8 times as much track as Guilford, and a fleet of freight cars 38 times the size of the Guilford fleet. The combined Norfolk Southern-Conrail locomotive fleet similarly overwhelms that of Guilford. In 1983, the combined operating revenues of Norfolk Southern and Conrail were 21 times those of the Guilford system and the combined Norfolk Southern-Conrail revenue ton miles were 22 times larger than Guilford's.

The relationship between a combined NS-Conrail and P&LE is even more disproportionate. The P&LE, one of the very smallest Class I railroads, has a single main line of track running from Connellsville, Pennsylvania through Pittsburgh to Youngstown, and it has existing trackage rights over a Conrail line into Ashtabula, Ohio. From 1982 to 1984, P&LE had net losses of over $50 million, representing close to 36 percent of its operating revenues. It is all but insolvent. In 1983, Norfolk Southern and Conrail -- which operate over nearly 85 times as much track as P&LE -- had combined operating revenues 142 times larger than those of P&LE and combined revenue ton miles 143 times larger than P&LE's.

To remedy the enormous anticompetitive impact of an NS/Conrail combination, it is proposed to sell Guilford track or trackage rights from Buffalo to Cleveland and from Cleveland to Chicago and St. Louis, and to provide it with spur lines to Indianapolis and Toledo. P&LE would get tracks or trackage rights from Pittsburgh to Cleveland and Toledo.

The idea that modest transfers of line fragments, of the kind now proposed, can turn these two financially ailing regional carriers into viable long-term competitors against the combined NS/Conrail system is, to put it mildly, fantastic. Not only do these carriers lack the financial wherewithal to compete with a giant like NS-Conrail, but they will fail every other realistic test of viability as well. Their route structures will be circuitous and inferior to those of their competitors. For example, between Buffalo and Chicago, NS-Conrail will have the benefit of a direct route along the south shore of Lake Erie, through Toledo and west. Guilford, by contrast, will be forced to haul its traffic - whatever there is of it -- south over a divested line through Lima, Ohio, and then north again to Chicago. A large segment of the track proposed to be divested to Guilford in Indiana and Illinois running to St. Louis has, in fact, already been proposed for abandonment by Norfolk and Western -- presumably because it is inferior to an existing, and substantially parallel, N&W line.

There are other problems with the divestment tracks as well. On the road between St. Louis and Delphos, Ohio that is proposed to be divested to Guilford standard six-axle freight diesels are banned because of weak bridges. Similarly, the road into and out of St. Louis which Guilford is to purchase can only handle traffic speeds of 25 to 35 miles per hour. By contrast, the competing route to be retained by NS-Conrail is capable of handling speeds of up to 70 miles per hour.

Because of their route structure, the poor quality of track to be divested to them, and the limited traffic that will be available, Guilford and P&LE will likely experience very low traffic densities as compared with those of Norfolk Southern-Conrail. For example, it is proposed that Guilford receive the Norfolk Southern's current Buffalo to Cleveland route which handles only one-fourth of the traffic handled by the parallel Conrail line which the merged entity intends to retain.

Similarly, the route into and out of St. Louis to be transferred to Guilford carries less than 1% of the traffic volume carried by the proposed Norfolk Southern-Conrail route. Low traffic density will mean not only non-competitive revenues but greatly increased per unit maintenance costs for the divestees. At the same time, every relevant aspect of their operations -- operating revenues, tons, revenue ton miles, gross ton miles and miles of road -- will be, as I have already indicated, dwarfed by those of their principal competitor, NS-Conrail.

Moreover, even if the Guilford and the P&LE are able to surmount these obstacles, they will face Norfolk Southern-Conrail's ability to cancel reciprocal switching arrangements, shut down now friendly gateways and close off their routes. And NS in certain areas will retain trackage rights over Guilford which will allow it to retain shippers and discipline any possible independence by Guilford. It is a strange process indeed that somehow allows the monopolist to choose its competition, the tools of competition, and the rules of the game.

Even NS's Mr. Robert Claytor -- who has no reason to underestimate -- has said that the divestitures will result in only $100 million per year in traffic diversion from the combined NS-Conrail system to competitors. Even assuming that Guilford and P&LE obtain all of that revenue, and other possible NS-Conrail competitors none of it, the combined revenues of these two minicarriers would still be only a fraction -- probably not much more than 5% -- of that of NS-Conrail.

If recent decades have taught us anything about railroads, it is that big railroads can compete effectively against each other, but that little railroads, over time, cannot compete against the big ones. Indeed, there are remarkable similarities between the present divestiture plan and the unsuccessful trackage rights schemes that were implemented for the Delaware & Hudson in the 1970s. If anything, however, the present proposal is even less workable. Here the idea is to have two small and financially dubious regional railroads, with hand-me-down tracks, provide the necessary competitive counter weight against what will be, by most measures, the biggest railroad in history -- with revenues in the billions and supported by a monopoly base in the key industrial states of the Northeast.

CSX Supports an Independent Conrail

As a matter of transportation policy, we think it is very clear that there is one thing that Congress should not do. It should not approve the sale of Conrail to Norfolk Southern -- under any circumstances. There may well be other reasons why this sale should not be approved, but the destructive impact of the sale on the nation's transportation system is reason enough. An NS/Conrail combination is, quite simply, the most anticompetitive option.

What, then, should Congress do? We think Congress should require a public offering of Conrail's stock. This will accomplish the important goal of returning Conrail to the private sector of the economy, but will do so without the destructive impact of a sale to Norfolk Southern. CSX will participate financially in such offering although we would not, of course, seek any controlling interest.

As you know, when the return of Conrail to the private sector began to be discussed in 1983, there were many who doubted that Conrail could be viable as an independent railroad. We at CSX were among them. We did not think that a railroad with the background of problems that Conrail has had could recover to a point where it would be able to compete with railroads like Norfolk Southern and CSX.

Mr. Crane and his management team have convinced us otherwise. Conrail has recovered. Five hundred million dollars tell us so. Substantial credit for this must go to Conrail's management, as well as to Congress and the Staggers Rail Act, which has returned much of the railroad industry to health. Conrail has used its freedom under the Staggers Act creatively and to its great benefit. We at CSX can readily attest to the fact that Conrail, in a relatively short period of time, has been transformed from a moribund and decrepit railroad into a strong and aggressive competitor. It does not need Norfolk Southern's protection.

In conclusion, the eastern part of our country now has the benefit of a balanced rail system with three healthy competitive railroads. A Norfolk Southern-Conrail combination would immediately and irreversibly destroy that system. The divestiture proposals would not rectify the situation -- they would simply create weak, small railroads that themselves would be candidates for bankruptcy. A public offering of Conrail stock, which would preserve the system, deserves a chance.

Thank you.

Wall Street Journal, April 25, 1983, at 1, col. 6.

Bad Signals

N&W Railroad Learns Hard Lesson in Getting Along in Coal Country

It Refuses to Cut Rates to Aid Miners, Until Forced to By Ire of West Virginians

What Will the Analysts Say?

By BILL PAUL

Staff Reporter of THE WALL STREET JOURNAL

IAEGER, W. Va.—Miners who inhabit the ridges and hollows of southern West Virginia are accustomed to swallowing adversity right along with the fine coal dust that settles like a shroud into every crease of the hard-scrabble landscape.

But late last year, with recession causing misery in the coal fields, the people in these parts began to air long-simmering resentments. The focus of their wrath: Norfolk Southern Corp., a giant railroad that, in its own attempts to grapple with the recession, ran afoul of the coal industry, which had long been its bread and butter. A close look at the still-festering controversy suggests the bitterness bred of hard-core unemployment, and the perils for companies that ignore or underestimate it.

Through its Norfolk & Western subsidiary, Norfolk Southern has long enjoyed a virtual monopoly on coal-hauling in southern West Virginia. Coal has always been good for the railroad, the nation's fourth-largest. In 1982 it accounted for more than 35% of the line's $3.36 billion revenue.

Last year, hard-pressed coal operators figured it was time for the railroad to return the favor. To help stimulate the mining industry and reduce the region's roughly 40% unemployment rate, they called on Norfolk Southern to sharply reduce its coal-hauling rates.

Test of Strength

Norfolk Southern resisted, mindful that lower rates would reduce its revenues and jeopardize its blue-chip reputation on Wall Street. Indeed, many saw the dispute as a test of whether railroads could withstand freight-rate discounting pressure now that those rates are negotiated, rather than regulated by the pro-carrier Interstate Commerce Commission. The long-term profitability of Norfolk Southern and other railroads was at stake, it was argued.

Many West Virginians saw it differently: "People feel they've contributed to the railroad's success and now, when the crunch is on, the railroad isn't willing to help," said Clayton Hale, a former highway-maintenance worker echoing widespread public opinion. The rate dispute quickly boiled over into a free-for-all recitation of accumulated grievances against the railroad.

In the end, Norfolk Southern buckled under, granting a discount to a major coal shipper at a much-publicized news conference in March. The legacy of ill will remains, however. And industry analysts worry that Norfolk Southern, in being backed into so public a concession, is now vulnerable to demands from other coal producers and buyers for similar discounts.

'Tremendous Pressure'

"Norfolk Southern is under tremendous pressure now," says Jack Kawa, a railroad analyst for Dean Witter Reynolds Inc. "If the rate-cutting becomes widespread, (the railroad's) profits will be significantly hurt." Mr. Kawa adds that, because of pressure from coal producers, Norfolk Southern recently made a modest 0.5% rate cut for its contractual export customers.

The event that catalyzed sentiment against the railroad occurred in December. It was then that a big Northeast utility, New England Electric System, announced that it wasn't renewing its contract to purchase 400,000 tons of coal annually from two southern West Virginia mines owned by A.T. Massey Coal Co. of Richmond, Va. In explaining its decision, the Westborough, Mass., utility said Norfolk Southern's hauling rates were too high.

Instead, the utility said it would buy 400,000 tons of coal from mines served by a carrier offering lower hauling rates. Consolidated Rail Corp. (Conrail's rates were lower in part because the mines it serves are in Pennsylvania and northern West Virginia, a shorter distance from the utility's power plants than the Massey mines.)

Layoffs Loom

News of the canceled order was followed by the grim announcement from Massey that it would lay off 250 miners in mid-February. To the people of southern West Virginia, worrying that they or their friends or relatives would be among those let go, the villain was clear: "The railroad is the bogyman," declared Ebb K. Whitley, a dentist who is McDowell County's Democratic chairman.

Lacy Wright, the area's popular state senator who aspires to run for Congress, was quick to seize on the issue. In late December, he vowed that he would "take appropriate steps to see that (the railroad) suffers along with the rest of West Virginia's people." Marching to the railroad's offices in Roanoke, he threatened to "stop the railroad in southern West Virginia" by seeing that county prosecutors—whom he called his "personal friends"—enforced the multitude of state safety and environmental laws to the letter. Such tactics as strictly enforcing anti-noise regulations and imposing five-mile-per-hour speed limits as trains passed through a succession of tiny hamlets could have crippled Norfolk Southern, whose main east-west line runs through the region.

By January, railroad analysts were deeply troubled by the dispute and its implications for the line's profitability. "This coal-rate situation bothers us most of all," one pointedly told Norfolk Southern's chairman, Robert B. Claytor, at a meeting in New York that month. Another said privately that if the carrier gave in to the utility's demand for a discount in the area of $5 a ton off the going rate of about $15 a ton—and if that discount became widespread—he would issue a "sell" recommendation.

'They're Lashing Out'

Thus, Norfolk Southern found itself caught between political and financial adversity. "This is the toughest pressure I've been under in 20 years," conceded William Bales, the line's vice president for coal and ore traffic. West Virginians, he said, "are lashing out at us."

Cornered, its every move scrutinized by an increasingly critical public, the railroad had little choice but to grant New England Electric a discount—reportedly in the range of $2 to $3 a ton—thereby saving Massey's contract with the utility and the miners' jobs.

Before emotions reached a fever pitch, Norfolk Southern actually had other options. At one point, the railroad apparently had decided to allow the New England Electric contract to lapse, figuring that toughing it out would signal to Wall Street and coal shippers alike that it could withstand rate-reduction pressure. Another alternative would have been to quietly accede to the utility's demands, thereby avoiding the embarrassing hoopla of a televised news conference presided over by West Virginia's Gov. Jay Rockefeller.

The railroad bungled these opportunities, observers say, partly because it was so unprepared for the outpouring of local resentment. Perhaps because Norfolk Southern has always had a monopoly on coal hauling in the area, it had never felt compelled to burnish its public image. Whatever the case, the coal-rate controversy was merely the flash point and state Sen. Wright the match that ignited long-smoldering public animosity.

"God bless Lacy Wright," declared Rev. Roger Yates, a fundamentalist minister in McDowell County, after Norfolk Southern agreed to the discount.

'No—or Hell No'

Among those with longstanding grievances against Norfolk Southern is W.B. Swope, a former mayor of Welch, the biggest town in the area near Massey's mines. Describing a time when the line "rudely and emphatically" turned down his request to buy a parcel of land for a municipal parking lot, Mr. Swope observes: "You can say 'no' or 'hell no.' The railroad said 'hell no.' "

Junk dealer Chester Matney is equally disgruntled. "The railroad doesn't give a damn about us small shippers," he says, explaining that the carrier recently pulled out its local service representative, a man upon whom Mr. Matney had depended for years.

Mr. Yates, the minister, says he had approached the railroad trying to buy land on which to build a new church. "I told them I'd pay a fair price, but they wouldn't even consider it. They'd rather keep the whole county locked up."

As publisher of the Welch Daily News, David Corcoran has chronicled the area's run-ins with the railroad. "We're tired of being kicked around," he says. Once, he recalls, the railroad drastically raised the fee that the War, W. Va., Catholic church paid to lease railroad land it used for its parking lot. "The railroad doesn't care how it affects people," Mr. Corcoran says.

There are a variety of other complaints, ranging from the closing of the Welch station last fall as a cost-cutting move to general foot-dragging on a promise to fix rough railroad crossings in Iaeger. "I wish that the N&W was as quick to fix rough crossings as they are to raise coal-hauling rates," wrote the editor of the Iaeger weekly newspaper, Tony Johnson.

Mending Fences

Norfolk Southern officials, while clamping a tight lid on public comment after the press conference, have nevertheless begun a fence-mending operation in the area. The railroad, for example, recently allowed Mr. Wright to announce that it was withdrawing a 1% coal-rate increase that had previously been announced.

Meanwhile, state politicians have milked the issue for all it is worth. Mr. Wright's headline-grabbing head start in challenging the railroad prompted his political opponents to rally around with equal fervor. With Mr. Wright a potential rival for his congressional seat, Rep. Nick J. Rahall joined Gov. Rockefeller in negotiations with the railroad to try to save the utility contract.

At the March 2 press conference, the governor said that he and Rep. Rahall had been instrumental in saving the "Massey 250" by persuading Norfolk Southern to institute a "competitive rate structure" for West Virginia coal. When asked whether this meant that other coal shippers could expect discounts, Norfolk Southern's Mr. Claytor said no, but Gov. Rockefeller's implication was clear.

The railroad's recent conciliatory moves have done little to dispel public criticism. Some point out that although 250 jobs were saved, hundreds more may have been lost because the railroad tarried in cutting New England Electric's rates. While the railroad pondered its decision, they say, Massey mines lost out on new business that the utility offered to mines outside the area.

Now that Norfolk Southern has been publicly identified as a cause of the area's economic ills—joining such other devils as Reaganomics and imported steel—it is likely to stay in the public eye. "The railroad isn't out of the woods by a long shot," says Mr. Swope, the former mayor. Indeed, Mr. Wright and another state senator have called for an investigation of the railroad's maintenance expenditures following two recent derailments in the area.

Mr. Wright vows to "stay on top" of the rate issue, and predicts that "other coal companies now stand a better chance of getting lower freight rates."

Just where does this leave Norfolk Southern's Mr. Bales, the man charged with trying to stave off other shippers seeking discounts? "My hair has gotten grayer since all this began," he says with a sigh, adding that the situation will remain tense at least until the economy picks up and more miners return to work.

CSX
Corp

Suite 560, National Place
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 783-8124

P. O. Box C-32222
Richmond, Virginia 23261

April 16, 1985

The Honorable
Strom Thurmond
United States Senate
Washington, D. C. 20510

Dear Chairman Thurmond:

By letter of April 4, 1985, you asked me to respond to four questions. Enclosed are my responses.

I would be happy to answer any further questions, and once again may I take this opportunity to thank you for the opportunity to testify before your Committee.

Sincerely,

John W. Snow

John W. Snow
President and CEO
Chessie System Railroads

Attachment

CSX Corporation is the parent company of The Chessie System Railroads, Seaboard System Railroad, Texas Gas Resources Corporation, The Greenbrier Resort Hotel, CSX Beckett Aviation Inc., CSX Minerals Inc., CSX Resources Inc. and various coal, oil and gas development enterprises

Q. What effect will this merger have on CSX traffic to the Northeast?

A. We have estimated that CSX will lose approximately $400 million in revenue should there be a merger of Norfolk Southern and Conrail. This will occur in various ways. Today, Conrail has a virtual rail monopoly in several key states and areas of the northeast, such as New York, New Jersey, and a large portion of Pennsylvania, and New England. Conrail is a competitor of CSX and it is also a very important customer. Much traffic moves on combined CSX/Conrail routes. Similar traffic moves via NS/Conrail. Today Conrail is relatively indifferent as to the choice between NS and CSX except in terms of efficiency. This will not be the case after an NS/Conrail merger since NS will control Conrail and prefer the NS/Conrail routes to the exclusion of CSX.

Since CSX testified before the Judiciary Committee, we have prepared a more extensive analysis of the anti-competitive effects of a NS/Conrail merger and a copy is attached.

Q. We have been told by Chessie officials that the B&O is a weak third in the east-west market (25%), can it effectively compete with the proposed Conrail/Norfolk Southern in that market?

A. Enclosed are materials which indicate the vulnerability of the B&O. Once again understand that the B&O must interconnect with Conrail for much of its traffic. Lacking these connections, the B&O will become even more vulnerable. The B&O made about $21 million in 1982, $7 million in 1983, and $45 million in 1984. We would believe that a substantial portion of the $400 diversion we indicated in the preceding question would come off the B&O, thus critically damaging an already weak system. Again, the paper we have enclosed details how this would occur, especially in the coal area.

Q. How will this effect the service provided to northern West Virginia?

Q. How will this translate into West Virginia jobs?

A. We would estimate that of the approximate 2,200 miles of CSX West Virginia routes, approximately 1225 miles are endangered. Of the approximate 6200 CSX rail jobs, 600 would be immediately lost, with long-term losses of up to 3400 possible. We are enclosing a paper that deals in more detail with impacts on West Virginia.

QUESTIONS: JOHN SNOW

PRESIDENT AND CEO, CSX CORPORATION

1. MR. SNOW, AS I UNDERSTAND IT, CSX CORPORATION WAS ORIGINALLY CONTACTED BY THE DEPARTMENT OF TRANSPORTATION TO CONSIDER SERIOUSLY ACQUIRING AN OWNERSHIP INTEREST IN CONRAIL. IN JUNE, 1984, CSX SUBMITTED A PROPOSAL TO SECRETARY DOLE SEEKING WHAT YOU TERMED AN "EQUITABLE RESTRUCTURING" OF CONRAIL, UNDER THE AUTHORITY OF THE RAILROAD REVITALIZATION AND REGULATORY REFORM ACT. ESSENTIALLY, THIS WAS A PROPOSAL TO CARVE CONRAIL UP INTO PIECES. YOU WERE FAIRLY CRITICAL OF THE FUTURE ECONOMIC POTENTIAL OF AN INDEPENDENT CONRAIL AND STATED QUITE CLEARLY THAT YOU DID NOT BELIEVE THAT THE NORTHEAST COULD SUPPORT THREE MAJOR, DUPLICATIVE RAIL SYSTEMS. CSX TALKED EXTENSIVELY ABOUT CONRAIL'S ERODING TRAFFIC BASE AND THE DETRIMENTAL EFFECT A SERIES OF ECONOMIC RECESSIONS COULD HAVE.

NOW, HOWEVER, YOUR STORY HAS CHANGED. NOW CSX SEEMS TO BE AN ENTHUSIASTIC SUPPORTER OF A PUBLIC OFFERING FOR CONRAIL. IT WOULD SEEM THIS IS SOMEWHAT DISINGENUOUS SUPPORT FOR AN IDEA THAT YOUR COMPANY SEVERELY CRITICIZED LESS THAN A YEAR AGO. WHY IS CSX NOW SUPPORTING A PUBLIC SALE AND WHAT CONDITIONS HAVE CHANGED IN THE INTERIM?

2. IN THE SAME LETTER, CSX SET FORTH THE TERMS OF A BID IN THE EVENT DOT WENT FORWARD WITH A SINGLE ENTITY SALE. THOSE TERMS WERE REALLY QUITE SIMILAR TO THE TERMS OF THE WINNING NORFOLK SOUTHERN BID: PAYMENT FOR THE COMMON STOCK HELD BY THE GOVERNMENT, WAIVER OF THE INVESTMENT TAX CREDIT AND NET OPERATING LOSS CARRYFORWARDS, CANCELLATION OF THE DEBT INTEREST OF THE U.S., AND NEGOTIATION OF REASONABLE TERMS WITH LABOR. NOW, HOWEVER, WE ARE HEARING A GREAT DEAL ABOUT THE "GIVEAWAY" THE GOVERNMENT WOULD COMMIT IF WE WENT FORWARD WITH THE NORFOLK SOUTHERN SALE. HOW COULD THE TERMS OF THAT SALE BE IMPROVED? WHAT WOULD CSX OFFER THAT WOULD IMPROVE THE FINANCIAL RETURN TO THE AMERICAN TAXPAYER? WHY DIDN'T CSX GO FORWARD WITH ITS BID?

CSX Corp

Suite 560, National Place
1331 Pennsylvania Avenue, N. W.
Washington, D. C. 20004
(202) 783-8124

P. O. Box 3-2222
Richmond, Virginia 23261

April 16, 1985

The Honorable
Joseph R. Biden
United States Senate
Washington, D. C. 20510

Dear Senator Biden:

After my appearance before the Senate Judiciary Committee, you asked me to respond to two questions, which are attached. The following are my answers:

Answer to Question I:

CSX in its original proposal to the U. S. Department of Transportation did propose a restructuring of Conrail between CSX and NS, with possible participation by other carriers. Although the Secretary of Transportation rejected our proposal, she is now considering a restructuring between NS and two smaller railroads. In both proposals, a restructuring is proposed in the sense that all properties would be transferred with none left behind. I say this because the term "carving up" has a certain pejorative connotation which does not seem appropriate to our original proposal.

We based our proposal primarily upon our assessment that a purchase of Conrail by one railroad would be highly anticompetitive. This information was conveyed to the Department of Justice as they now admit. We also believed that there were certain long term risks involved in the continued operation of these railroads in the northeast.

In all sincerity we believe our proposal was the best proposal and was rejected for political considerations. We accept this rejection, and being reasonable people and determined not to allow the "best" to be the enemy of the good, we now believe that the public offering is the most preferable course among the alternatives now available.

The alternative to the public offering is a highly anticompetitive takeover of Conrail by NS that would forever change the nature of surface transportation in the United States. Even the Justice Department said that such a takeover would be highly anticompetitive. The Department, in an attempt to approve the transaction, proposed what can only be called a bizarre transaction involving second and third rate lines of one insolvent carrier and one marginal one who purchased their last rail asset for something less than the price of a Georgetown townhouse. It is somewhat curious that those who voice concern about the future of Conrail are so willing to accept the future viability of the PL&E and Guilford, a combination now commonly referred to as "Frail Rail". Thus, in a world of the imperfect, when faced with the choice of some long-term uncertainty in the northeast versus the anticompetitive nature of an NS/Conrail merger and the obvious frailities of PL&E and Guilford, our choice was an easy one.

In addition, in the last year much has come to light to support Conrail's viability as an independent entity. Conrail's profitability has been little short of a miracle, which has taken many by surprise. I am sure you are aware of the recent USRA report which concludes that Conrail is a very viable railroad. I was impressed with Assistant Attorney General McGrath's testimony before your Committee that Conrail was viable, and even Mr. Claytor in his testimony had to admit that Conrail would not have problems in the next few years although he hinted at some problems that might occur seven, eight, or nine years out. Finally, John Riley, the FRA Administrator indicated to the Alleghany Corporation that Alleghany was his choice. This occured just before the Secretary's designation of NS, and was conveyed to us by the Alleghany counsel literally in minutes of the decision. Obviously, Riley's preferance for Alleghany must mean that he had concluded that Conrail could stand alone.

Answer to Question 2:

Our letter to the Secretary proposed a restructuring. We did reserve the right to bid on Conrail and in a general manner indicated some of the terms of the bid. These were terms that were generally conveyed to us by the Department or its investment banker. We did not, however, include a very important item: the price. We did, however, indicate that if we made a single bid, it would be with a proposal advantageous. Therefore, I believe it is impossible to compare our proposal to the NS.

As a further thought, I should point out that tax advantages have a different value to different persons. CSX or an independent Conrail could not use the tax benefits of Conrail anywhere near the extent or as quickly as NS. Therefore, the tax benefits are much more valuable to NS. To put it another way, even if the public offering and NS raised the same amount, the net effect to the government would be very different. We are attempting to make such a calculation, and our initial analysis is that the value of the tax benefits is worth substantially more to NS- - several hundred million dollars more.

As to why CSX did not bid, we simply believed that the antitrust laws would be enforced and that a bid on our part would just be a bit of puffery.

The **Chairman**. Mr. Burdakin, would you care to proceed.

STATEMENT OF JOHN H. BURDAKIN

Mr. **Burdakin**. Mr. Chairman, I am John Burdakin, president of the Grand Trunk Western Railroad and two other subsidiaries of the holding company but the concern today is the GTW.

My statement originally contained a great deal of what would be reiteration in the area of the inadequate study, the lack of concrete and factual information that has gone into the conclusion of selling Conrail to the NS at this point. And I would just like to say that I second those problems that have been expressed on both sides of this table, from the Senators as well as here..

But I would like to go back to a statement of Mr. McGrath, and that is he said that we should divestify for a third competitive system, and he used the term, "long term, viable, competitive service."

I have been in the operating business and the management of the railroad since 1947, and I want to tell you a little bit about this thing called competitive service. We seem to wrestle with it with great difficulty this morning. Competitive service means that you have to go to the customer and offer him a service that is superior to anybody else. You have to get the car to where its destination is or to the interchange point at least equal with anybody else. You have to have the equipment equal to anybody else. And you have to have the rates that are equal to anybody else, and if you have those three, if we disregard market power, if you have those three you can render competitive service.

The way you get rates to be equal is to be able to have volume and thus have the unit cost down. Now, the divestiture that has been offered here, in my opinion and speaking just from the area that we are interested in, and that is Detroit and Toledo west to St. Louis and a line up to Chicago; that line cannot perform competitive service as has been requested and specified by Mr. McGrath.

The Grand Trunk last week approached the NW with an offer to buy competitive service lines going to St. Louis and Chicago. I hope that Mr. Claytor's no was to a question of are you negotiating, and if that was the question, then the no was appropriate. And I hope that no was he will not negotiate with us in the future in regard to buying 900 miles of line in Michigan, Indiana, Illinois, and a little bit in Ohio to perform and to conform with what Mr. McGrath and the Department of Justice is saying for long term, viable, competitive service.

We are able to finance this with a group of American investors that are willing to go in with the Grand Trunk on this. The operation would be integrated with the Grand Trunk, and it would perform and would be able to continue with long term, viable service.

We are calling this the Grand Trunk Wesline. We believe that it is a solution; it is an alternative solution that fully meets the requirement of the Department of Justice and that in turn is another alternative.

Now what that does, of course, is bring a great deal of controversy to this issue, and obviously because of these hearings you can tell there is tremendous controversy. And what we are saying is that this is too complex an issue to be decided the way it has been going. It takes experts to understand how railroads merge, the market power that Mr. Snow talked about, how those all fit together and what is the impact on the various publics. And those publics that I am talking about is the Nation, even into the security of the Nation, to the employees, to the shippers, to the communities that we serve.

And we have not up to now had sufficient information to evaluate and weigh these alternatives. Now, I suggest that should happen, and I suggest to the Senate and to the Congress that this matter should be referred to an agency or an organization that has expertise in this line. The ICC certainly has it. USRA has it or at least had it. And I think that that can be done and can be done without delaying this whole transaction. I do not believe that the solution that we are talking about today—that is, the flat, outright sale of Conrail to NS, the divestiture of noncompetitive lines in the West—I do not believe that that is good for employees, it is not good for the shippers, it is not good for the communities that are served by these railroads. And it is not good for the country and the rail network of this country.

And I suggest that the Congress should refer this matter to somebody that has the time to be able to bring out into the open financial statements, employee relocations, these things that are normally done by the ICC, bring them out into the public. Thank you, sir.

[Statement follows:]

TESTIMONY BY
JOHN H. BURDAKIN, PRESIDENT
GRAND TRUNK WESTERN RAILROAD COMPANY

BEFORE THE
COMMITTEE ON THE JUDICIARY
U.S. SENATE

March 27, 1985

This Committee has before it a momentous task - to insure that the sale of the Government's interest in Conrail not result in a significant reduction of rail competition in the Northeast and Midwest regions of this country, and to remedy existing anticompetitive conditions to the degree appropriate in the context of this sale process. I would like to thank the Committee for inviting me to present Grand Trunk Western Railroad Company's views on this important issue.

Before turning to the substance of my comments, I respectfully suggest that this Committee not attempt the impossible - to reach a definitive conclusion as to whether the Administration's proposal to sell Conrail to Norfolk Southern Corporation (Norfolk Southern or NS) will unacceptably diminish competition in the Midwest and Northeast. Today you will hear two panels of railroad witnesses with very different views on that and related questions. However, it is difficult enough to identify the important factual issues which are in dispute during the one or two days of hearings you have scheduled. To resolve them during this period would be more than any legislative body could realistically hope to achieve.

I would suggest an alternative mission. This Committee should determine whether the process of deliberations between now and the approval of any particular proposal or series of proposals will be fair to impacted parties, and whether it will lead to the resolution of these important disputed questions by objective fact finders with expertise in transportation, as well as in competitive, issues.

Grand Trunk believes that the process contemplated by the Administration's bill (S.638)does not achieve those objectives. The Secretary of Transportation wants Congress to act on legislation that approves the sale of Conrail to Norfolk Southern before the details on that consolidation are finally negotiated and before the configuration of Justice Department mandated divestitures is known. The public and directly affected shippers and carriers have not and will not be given an opportunity to evaluate these plans under the process described in this legislation. This legislation gives the Secretary virtually unfettered and unreviewable discretion in resolving these uncertainties. Moreover, it would clothe the transaction with an antitrust immunity that will preclude private parties injured by this transaction, as well as the government, from seeking judicial scrutiny of this package.

It is essential that a thorough review process be completed before final Congressional action. If Congress commits itself to the Norfolk Southern transaction and the anticompetitive impacts are not adequately addressed by the divestiture plans or by the covenants agreed to by Norfolk Southern, there will be no turning back. Rail competition cannot be rekindled once its flame is extinguished because there are prohibitive barriers to new entrants.

The need for care at this stage, before the structure of the industry is reshaped, is further heightened by deregulation of the railroad industry that has taken place since the enactment of the Staggers Act of 1980. Competition and the free market are to be the regulators of the future, but if the structure of the industry provides no effective restraint on the exercise of market power, shippers and the public will be without recourse.

Grand Trunk recommends that this Committee request that an independent agency or agencies, such as the United States Railway Association (USRA) and the Interstate Commerce Commission (ICC), conduct an investigation open to all affected parties. That review process would resolve the disputed issues and would result in findings to be reported back to Congress before it takes final action on the Administration's bill. It will be said that DOT has already "investigated" the Norfolk Southern proposal and that another study will simply cause delay. To Grand Trunk's knowledge, no such study has been performed. Indeed, affected parties have not had access to it, or participated in the study process. Moreover, the details of the divestiture plans have not been decided and thus could not possibly have been studied.

The investigation we are requesting can be completed by the time Congress returns from its August recess, leaving adequate opportunity for legislative action consistent with the findings and for the parties to consummate any approved transaction before the end of the year.

I will now discuss the substance of Grand Trunk's concerns and attempt to identify those issues which must be resolved during this review process.

Background on Grand Trunk and A Summary of Its Position

Grand Trunk is one of a number of regional carriers that serve essential competitive roles in the key transportation markets impacted by the Norfolk Southern-Conrail merger. Grand Trunk operates over 1500 miles of railroad in Michigan, Ohio, Indiana and Illinois and directly employs over 4,000 workers in that region. Its affiliate, the Central Vermont Railway, Inc., operates over 350 miles of trackage in Vermont, Massachusetts and Connecticut and directly employs about 300 workers in those states.

Grand Trunk and other regional carriers will be devastated by the NS-Conrail merger, but the scope of the competitive impacts of the merger go far beyond the harm to individual railroads. Shippers and communities throughout the Eastern half of the United States will suffer a serious reduction in transportation alternatives, and will be confronted with one or at most two giant rail systems that will possess sufficient market power to dictate to all but the largest shippers monopoly prices for the services they choose to render.

Grand Trunk believes that the public offering proposal being suggested by my colleagues on this panel and others, or other alternatives which do not require the drastic restructuring implicit in the NS-Conrail merger, are far preferable because they do not pose the same risks to competition. Conrail is viable as a stand alone entity; there is no reason to select an option that threatens to destroy regional carriers and the transportation options that are available to shippers.

The Department of Justice study of the NS-Conrail merger identifies only a portion of the competitive problems caused by the transaction. Since it was designed to fix only the problems identified, the divestiture remedy prescribed by Justice is inadequate. If the NS-Conrail transaction is to be selected as the preferred option, it is essential that a divestiture plan be designed which can truly compete with NS-Conrail.

Grand Trunk has proposed two alternative plans to Norfolk Southern and DOT which it believes can satisfy the criteria set by the Department of Justice. Those plans have not been seriously considered because Norfolk Southern has no interest in divesting properties capable of providing effective competition. Based upon what we know to date about the divestiture plans preliminarily accepted by Guilford Transportation Industries (Guilford) and Pittsburgh and Lake Erie Railroad (P&LE), they offer no hope of providing long-term, viable competition to NS-Conrail, and are acceptable to NS for precisely that reason.

The covenants negotiated by the Department of Transportation (DOT) and Norfolk Southern are worthless. They provide only vague, temporary undertakings concerning the preservation of limited joint line routes and open gateways. If the protections were properly drafted they could provide shippers with some leverage in routing traffic even though they are otherwise captive to one railroad. However, the concessions negotiated by DOT offer no such leverage and joint routes with carriers the size of Grand Trunk would not be covered by the protections.

Before any definitive conclusions can be made about the anticompetitive impacts of NS-Conrail merger, or the adequacy of the remedies designed to correct them, more must be known about how Norfolk Southern intends to operate its combined system once it acquires Conrail. Several months ago we asked for this information from Norfolk Southern, and filed a Freedom of Information Act request seeking whatever studies or information DOT had in its possession. Those requests were refused. We can anticipate similar nondisclosure once the divestiture plans become finalized and Department of Justice begins its analysis.

Important issues of public policy which can seriously impact shippers, local communities and other carriers should not be conducted behind closed doors. The analysis of these plans must be done in a proceeding where minimal norms of due process are observed. The referral process suggested by Grand Trunk would achieve that result without imposing undue delay, and would also assure that these important issues receive the objective and expert analysis which they deserve.

An NS-Conrail Merger Threatens Competition

The proposed NS-Conrail merger will create a rail system of unprecedented size and market power. The combination will result in the largest transportation enterprise in North America with combined annual revenues of over $7 billion. NS-Conrail revenues will exceed the combined revenues of the eight largest motor carriers, one of which (North American Van Lines) is also about to be acquired by Norfolk Southern. The combined system will blanket a twenty-three state area with a network of over 32,000 miles of railroad. There will be over 5,500 stations on that system which are served by no other railroad and to which competitive access over joint line routes can be foreclosed at the whim of the NS-CR management.

The exclusive focus of the Department of Justice's competitive analysis has been the area west of Buffalo and Pittsburgh and east of Chicago and St. Louis where the Conrail and Norfolk Southern systems overlap and compete directly at stations they jointly serve. The Department did not consider the elimination of "indirect" and "source" competition.

What I call "indirect" competition relates to the ability of carriers which do not have direct access to a particular station or shipper to compete for business at that station either through a joint movement in conjunction with a third carrier that does serve that station, or through a joint line movement with the carrier serving that station over a route which short-hauls the serving carrier. For instance, Grand Trunk participates in movements to and from Michigan in conjunction with NS which are directly competitive with direct Conrail movements. That competition will cease once NS acquires Conrail. There are numerous other examples where shippers with traffic originating or terminating within territory served exclusively by Conrail, but moving to areas beyond Conrail's reach in competition with Norfolk Southern routes, will be left only with a NS-Conrail route. NS competitors will be forced from the markets in which they presently compete.

"Source" competition exists when carriers serve different points but the shippers at those points compete with each other. The carriers act as advocates for their respective shippers and compete with each other through pricing, development of innovative services and aggressive marketing in conjunction with the shipper on their line. When the two carriers merge the incentives are different, and this form of competition is lost.

The Department of Justice studied neither of these forms of competition and therefore could make no findings as to the degree they would be impaired by the NS acquisition of Conrail. But even in the region of the Department's principal focus, certain anticompetitive impacts were ignored. The Department measured competitive impacts by looking only at the common points served by NS and Conrail where one was already dominant in terms of the traffic volumes handled. Through this procedure they excluded from examination markets that may not have been dominated by NS or Conrail in the past, but where competition between them nevertheless existed and will in the future be eliminated.

In those markets Justice did study, it simply combined the historic traffic volumes handled by NS and Conrail, and then determined whether one or more other carrier historically handled a significant percentage of the business originated or terminated there so as to prevent the exercise of monopoly power. The problem with this *static* analysis is that it fails to take into consideration the traffic diversions that will occur as a result of the merger. NS and Conrail, once merged, will be able to do things together that neither could do alone in the past. A *dynamic* analysis, which takes into account the additional traffic diversions which will occur as a direct result of the merger, is the accepted method for measuring these impacts in merger proceedings at the Interstate Commerce Commission. Outside the transportation context, I am advised that courts require that the future competitive abilities of the merging companies be evaluated as well as their historic market shares. The Department of Justice specifically declined to review these impacts in its evaluation of the NS-Conrail merger.

The trouble with disregarding such impacts is that the analysis assumes that regional carriers like Grand Trunk will continue to serve as a restraining force in markets where they historically played a role. Speaking for Grand Trunk, the traffic diversions resulting from the merger may so weaken us that we will be prevented from continuing to offer truly competitive service in those markets.

I am not an economist or an expert in competitive analysis, but the studies performed by consultants retained by Grand Trunk report, on a preliminary basis, impacts beyond those identified by the Department. Commodities moving to consumers and from producers in cities like Cincinnati, Columbus, Buffalo, Detroit, Washington and St. Louis, not to mention scores of smaller markets, will be dominated by NS-Conrail. Yet these cities are not identified on the Department of Justice's list of endangered markets.

The Department of Justice nevertheless concluded that the sale to NS "would have a significant adverse effect on competition" and that "without appropriate divestitures ... would violate both Clayton Act and Interstate Commerce Act merger review standards." Unfortunately, the divestiture remedy prescribed by the Department addresses only the problem areas its inadequate analysis identified. The condition attached to Norfolk Southern's memorandum of intent with DOT - even if a viable divestiture plan were to result from it - would not counterbalance the full scope of injury to competition that will inevitably result from the transaction.

Similarly, the covenants negotiated between Norfolk Southern and DOT are inadequate on several counts. Secretary Dole has made much of these covenants in her arguments against the public offering alternative, but upon examination they prove to provide benefits that are at best illusory.

For example, the Secretary negotiated a covenant designed to reestablish joint line routes closed by present Conrail management. This is a laudable goal, but the provision fails miserably to create a long term, enforceable requirement of benefit to Grand Trunk or similar carriers. The provision lasts for only five years, and would not benefit carriers like Grand Trunk with more than $300 million in gross revenues. Competition is competition, and it is illogical to limit the period during which it should flourish, or to distinguish among carriers providing the competition based upon their size.

Reopening gateways and reestablishing routes is a complicated problem to be sure. However, the covenant agreed to by Norfolk Southern does not begin to grapple with the difficult issues. Its terms are vague, and it does not establish definite or enforceable standards. Since it is an arrangement between two other parties, it is not clear what rights of enforcement the intended beneficiaries would have.

Grand Trunk cannot accept vague platitudes contained in a contract between two other parties. We will propose for your consideration an amendment to the Administration's bill which will secure indirect competitive access to the stations served in territory dominated by NS-Conrail.

The Administration's proposed bill has a further deficiency. Section 104(a) of S.638 provides that:

> "[I]mplementation of the Secretary's Plan
> [defined as the Memorandum of Intent
> between DOT and NS and the divestitures

> outlined in the Department of Justice letter] and coordinated operation of [Conrail's] properties with those of Norfolk Southern Corporation...is deemed approved by the [Interstate Commerce] Commission under Chapter 113 of title 49, United States Code."

The bill does not come out and say it, but the effect of this language is to confer antitrust immunity. Transactions approved by the ICC automatically receive antitrust immunity under 49 U.S.C. § 11341, but not without a full and detailed analysis by the Commission. That analysis includes a due process hearing with rights of discovery and cross examination, and the opportunity to submit opposition and rebuttal evidence. Such investigations are permitted by statute to take up to 31 months from the time the detailed application submitted by applicants is accepted by the ICC.

None of the prerequisites to granting immunity have occurred in this case. Impacted parties, including Grand Trunk, have not the vaguest idea how the NS-Conrail system will be operated because we have never been provided with more than the most superficial public relations pieces on the transaction. Most important, the decision making process of DOT has not been conducted in the open or with modicum of due process. DOT and Justice have engaged in closed discussions with various parties, but have treated all submissions to them, as well as their own internal analyses, as confidential. The antitrust immunity should not be conferred under these circumstances.

If NS-Conrail is to be Approved, Congress Must Insist Upon Creation of a Sound Divestiture Plan

Strong medicine - not a placebo - is needed to rectify the anticompetitive problems associated with the NS-Conrail merger.

During the decade of the 1960's when Conrail's predecessor railroads were involved in merger proceedings, the Justice Department asserted that a long standing affiliation between the Pennsylvania Railroad (PRR) and the Norfolk and Western Railroad (N&W) created an unacceptable concentration of market power in the region, and that PRR should be required to divest entirely its controlling interest in the N&W. The ICC agreed, and ordered the divestiture. Much has happened in the intervening years, including a dramatic reduction in the number of independent rail competitors throughout the Northeast and Midwest. However, approval of a consolidation that links N&W's even larger successor (Norfolk Southern) with PRR's successor (Conrail) is more offensive to the principles underlying the antitrust laws today than it was during the earlier proceedings.

This time the Justice Department has recommended a divestiture plan that is more limited than it required twenty years ago, and as I have previously explained it does not go far enough. Nevertheless, the Justice Department letter sent to Secretary Dole does set tough standards for those divestitures which it requires.

The entities acquiring the divested properties must be "...capable of providing long-term, viable, and competitive rail service" in the rail corridor bounded by Pittsburgh and Buffalo in the east and St. Louis and Chicago in the west. They must possess " ... the managerial, operational and financial capability necessary to compete effectively, and to remain a viable entity providing long-term rail service along the designated corridor."

Even under the Department of Justice's inadequate identification of anticompetitive problems, the so-called "problem markets" involved traffic which accounted for $516.1 million in freight revenues. The divestiture plan in the Department's view should "resolve at least $371.4 million of the potential problems."

This is a tall order when it is remembered that the carriers acquiring the divested properties will be competing against a system with enormous financial resources, a top flight physical plant rebuilt with billions of dollars of taxpayer money, and large traffic volumes that will permit frequent train schedules in the same corridors as the divested lines.

Several months ago, Grand Trunk and the P&LE proposed a system of divested lines to Norfolk Southern and DOT which had a chance of meeting these criteria. It was called ProRail. It provides for access to impacted markets over lines which were selected because they have the following characteristics:

1. an adequate traffic base to ensure long-term viability and to render satisfactory frequency of service;
2. the ability to offer competitive schedules on or near the first day of operation so that the traffic and commercial relationships would not be forever captured by NS-Conrail;
3. need only minimum roadway capital expenditures for new connections and upgrading;
4. permit participation of regional carriers and the incentive to promote mutual cooperation; and
5. cause the least disruption to the operations of the NS-Conrail system.

The lines we identified using these criteria never received serious consideration because, under the Department of Justice letter, Norfolk Southern has been given the responsibility of proposing a divestiture plan. Naturally, Norfolk Southern has not been interested in discussing high quality lines with access to traffic in volumes essential to creation of a viable system. Instead, they identified a set of surplus lines, some of which were slated for abandonment, and were unwilling to discuss alternatives because other carriers found these lines to be acceptable. This is a classic case of the fox selecting the guardian for the chicken coop.

Nevertheless, Grand Trunk has developed a detailed business plan which demonstrates that ProRail can satisfy the rigid criteria set by the Department of Justice. With the announcement by DOT that there has been tentative agreement for certain divestitures to P&LE and to Guilford, Grand Trunk has set the ProRail proposal to one side. However, if it is determined that the tentative divestitures to P&LE and Guilford cannot achieve the level of service and profitability necessary to compete with NS-Conrail, Grand Trunk is prepared to move forward alone or in conjunction with other regional carriers to put ProRail together.

Grand Trunk has not sat idly while P&LE and Guilford have attempted to define their plans. Within the last week Grand Trunk has proposed to NS an alternative divestiture plan designed to dovetail with the P&LE and Guilford divestiture plans. We call this plan our West End Project. It would address the competitive problems west of Toledo and Ft. Wayne and bring Grand Trunk's traffic, managerial and financial resources to bear on the divestiture issue. As I will discuss below, the divestiture plans outlined by Guilford and P&LE are particularly weak in this region, and this alternative proposal can address those weaknesses.

The West End Project would provide direct access from Detroit and Toledo to the St. Louis and Chicago gateways via high quality Conrail and NS lines intersecting at Ft. Wayne, Indiana. These lines would be acquired outright or be jointly operated by Grand Trunk and NS-Conrail. Unlike the Guilford plan, this is territory Grand Trunk knows and in which it is capable of providing a credible competition to NS-Conrail.

These acquisitions would address the Department of Justice's concerns for preserving a competitor at points in this region, but based upon our preliminary analysis would not assure compliance with the equally important criterion that the acquirer provide "long-term, viable, competitive rail service" in the affected transportation markets. To address that concern we would propose to acquire the Conrail lines in Michigan.

The lines in Michigan have been said to the beyond the scope of the Justice Department's requirements. We disagree because the Department has identified Michigan counties as among the impacted counties. In addition, we believe that Norfolk Southern's acquisition of Conrail will have adverse consequences on competition throughout Michigan because it will lead to the demise of Grand Trunk, leaving only two rail competitors throughout Michigan. Our proposal would preserve two strong competitors throughout Michigan while preserving NS-Conrail's presence in the Detroit industrial market.

The key significance of the Michigan lines, however, is traffic. The traffic contributed by these Michigan lines is essential to the satisfaction of the Justice Department's criteria for viability and competitiveness.

I believe that competition throughout vast areas of Michigan will be adversely impacted by the NS-Conrail merger. But even if I were to accept the narrow definition of competitive impacts adopted by the Department of Justice, I have been advised by counsel that it should not preclude these Michigan lines from becoming part of the divestiture plan. In its 1979 report to the President, the National Commission for the Review of Antitrust Laws and Procedures (known as the Shenefield Commission), on which Senators Metzenbaum and Kennedy served, was critical of partial divestitures, limited strictly to so-called "offending assets," which failed to result in creation of a viable entity.

> "[T]he view more consistent with the purposes of the antitrust laws is that the remedy ought to bring about "workable competition." Divestiture should include assets sufficient to create a viable entity or attract a procompetitive purchaser. If the "offending" assets are insufficient, the court should order additional, "non-offending" assets divested."

Grand Trunk is willing to consider methods for achieving the viability of the divestiture plans other than through conveyance of the lines in Michigan. However, the proposals placed on the table by Guilford west of Toledo do not come close to satisfying the Justice Department criteria for "long term, viable, and competitive rail services to locations along the corridor." For that reason Grand Trunk's West End Project deserves serious consideration.

To provide effective competition with a giant rail system that will be operating ten to fifteen trains per day in each direction between major cities in certain corridors identified by DOJ, the carriers operating the divested lines must have a strong traffic base and a modern physical plant. The plans offered by Guilford and P&LE fail miserably on both scores, particularly west of Toledo.

The meager traffic base of the Guilford and P&LE plans is not adequate to provide daily through freight train service within the corridors identified by the Department of Justice. Our preliminary traffic analysis shows that the Guilford and

P&LE divestiture plans will be able to attract on a combined basis no more than 132,000 carloads of freight from the shippers located along the lines to be acquired and from shippers which Guilford and P&LE presently serve that have traffic which can be routed over the divested lines. In certain corridors they will not be able to justify daily train service.

For instance, traffic volumes to and from St. Louis will permit Guilford to operate at most five short trains per week in each direction. Annual traffic densities expressed in million gross tons per mile is a useful measure of viability. The ICC classifies lines with less than 3 million gross tons per mile as feeder lines. Guilford's "main line" to St. Louis will have only 2.1 million gross tons per mile and will be in no position to provide effective competition to NS-Conrail in this corridor. A similar problem exists in the Chicago corridor.

The density of traffic originations is another measure. On a combined basis, the P&LE and Guilford plans involve lines with less than one half the national average of carload originations and about one third of what the Norfolk and Western lines in the region generate. The sparcely populated lines to be acquired by Guilford west of Toledo are the principal reason for these undesireable ratios.

On the traffic Guilford and P&LE will be able to attract to their expanded system, they will be subject to short hauling by NS-Conrail or CSX. However, assuming Guilford and P&LE retain all 132,000 carloads, and assuming further that they receive the same average revenues received by NS and Conrail during 1983 (i.e. no short hauls by NS-Conrail), the combined gross freight revenues to be generated by Guilford and P&LE would not exceed $106.5 million per year.

These estimates are to be compared with the traffic estimates for the ProRail system which were computed using the same traffic model. ProRail would attract 354,000 carloads with $359 million of gross freight revenues. ProRail is profitable at these levels, but is by no means a bonanza. The traffic benchmark set by the Department of Justice for the divestiture plans, mentioned previously, was that the plans should compete at least $371.4 million of the $516 million of traffic that was originated or terminated in problem markets. It is clear that the P&LE and Guilford plans do not come close to this standard.

The P&LE and Guilford plans also fail the other critical prerequisite for viability: adequate facilities, requiring minimal capital expenditure and capable of providing efficient service. Again, this is principally a problem on the lines west of Toledo. Guilford has agreed to acquire the cast-offs from the NS-Conrail system which cannot hope to satisfy this prerequisite. In many cases the trackage is in poor condition and the access to impacted markets is indirect or over trackage rights where NS-Conrail dispatchers will control their competitor's freight operations.

The line to be acquired for access to the St. Louis gateway is truly a streak of rust for 133 miles east of Frankfort, Indiana. This segment has mostly second hand, non-control cooled rail weighing 90 and 100 pounds per yard which must be replaced with continuous welded rail weighing not less than 115 pounds per yard. On the segment west of Frankfort, NS has already slated 163 miles for abandonment. Bridges along the right of way are subject to weight restrictions that prevent use of modern six axle diesel locomotives over this route.

The maximum authorized freight train speed on existing NS and Conrail major freight routes in the impacted corridor is mostly 50 and 60 mph for manifest trains and 70 mph for certain dedicated intermodal trains. To get Guilford's line to St. Louis in shape so that it can permit an authorized speed of 49 mph, our consultant estimates that a minimum of $45 million must be expended for new rail, ties, ballast and related materials. Conrail management has estimated that the investment in this line necessary to operate high speed service comparable to that rendered by NS-Conrail would be $110 million.

Other segments to be acquired require lesser, yet still significant capital expenditures. Even if the lines were given away, one wonders how expenditures of the magnitude required can be justified given the scarce resources of the carriers involved and the existence of superior lines on NS-Conrail.

ProRail and our West End Project contemplate coordination and cooperation among the regional carriers. Conversely, Guilford and P&LE have not announced any cooperative efforts or plans for coordinated operations and service. Grand Trunk would be willing to coordinate its services with any system made from divested lines, provided it is capable of rendering competitive service. Our shippers will not tolerate inferior service, and we would jeopardize our participation in the traffic if we were to promote such routings. Unfortunately, the present proposals by Guilford west of Toledo will not provide service we can promote. Therefore, it can only be assumed that the Guilford and P&LE expanded systems under the their proposed divestitures would be operated as independent, competing entities, and that Guilford would also be competing with Grand Trunk. especially on traffic moving between Chicago and Buffalo.

Clearly, a satisfactory divestiture plan has not been identified to date. It is for that reason that a more deliberate investigation must be undertaken to determine whether such a plan or plans can be fashioned. To pass legislation authorizing the sale of Conrail to Norfolk Southern before that process has been completed involves risks too great for Congress to take.

Conclusion

At the outset of my comments I expressed the view that this Committee should not attempt to do more than it is capable of doing. I have taken positions on competition and the viability of the divestiture plans which are certain to be disputed by others testifying today. However, the level of discussion, by necessity, is at the broadest level of generality. Both sides to this dispute should be forced to come forward with their studies and their experts before an independent agency competent to determine the true facts.

It is too early to begin that process because as of this date very little is known about the proposals advocated by Norfolk Southern and the Administration. That information should be made available to affected parties, with adequate precautions taken to protect commercially sensitive data.

The lack of information or an opportunity to evaluate the impacts of the Administration's proposal are problems raised not only by Grand Trunk. The Executive Vice President of the National Industrial Transportation League has written a letter to Senator Danforth expressing the following concerns of its shipper membership:

> "...I would like to convey the growing apprehension being expressed to me by League members about the expedited handling of the Conrail sale which could foreclose the opportunity for those directly affected to provide meaningful input in this process.
>
> "...We maintain that shippers have not had sufficient opportunity to analyze all the options available since the Secretary of Transportation announced the decision to sell Conrail to the Norfolk Southen. Lack of meaningful information on rail lines to be sold, financial matters, and other issues precludes timely and constructive evaluation of the issues and input to your Committee. The rush to judgment on this matter is unnecessary. A full analysis and review of the sale process by appropriate Congressional committees should be made. Legislation should not be progressed until shipper concerns are met."

I subscribe to these sentiments and earnestly request that the Committee require that the sales transaction and divestiture plan be subjected to the scrutiny of a review by an independent agency qualified to resolve these complicated transportation issues.

The CHAIRMAN. Thank you. Senator McConnell, are you going to be able to stay long enough to ask some questions?

Senator MCCONNELL. Yes, Mr. Chairman. I have a few I would like to ask, yes.

The CHAIRMAN. Do you want to go first or do you want me to go first?

Senator MCCONNELL. Well, if you do not mind, Mr. Chairman——

The CHAIRMAN. Do you have to leave?

Senator MCCONNELL. It would be helpful.

The CHAIRMAN. Well, go ahead.

Senator MCCONNELL. I do not want to inconvenience you.

The CHAIRMAN. That is all right. I will yield to you. Go ahead and ask questions of all three of them.

Senator MCCONNELL. Thank you, Mr. Chairman. I will not take but a minute.

Mr. Snow, I have been in the public service before coming here and I am accustomed to getting correspondence from my constituents, but I must say I have never gotten as much as I have in recent weeks from Kentuckians. I do not know if you happened to have noticed the article in today's Courier Journal, the little newspaper that covers Kentucky; headline: "Firm Provided Sample Letters."

Let me read you the salient portions. It says, "In a battle over the proposed sale of Conrail, a CSX Corporation subsidiary provided its employees with free postage and sample opposition letters to write to their Senators."

"Letters should be handwritten or typed on plain paper or personal stationery, sealed in individually addressed envelopes, and given to supervisors as soon as possible or by no means later than Monday, March 4th." said a Texas Gas Transmission Corp. notice addressed to all employees last month.

"Texas Gas will provide postage for all letters," the notice said.

Now, you know, I do not have any objection to receiving lots of letters. I think that is part of the system, but it does raise the question of whether or not it is the CSX's policy to provide in addition to the draft free postage for all of its employees and it subsidiaries and their employees to lobby us on this issue.

Mr. SNOW. Let me answer that, Senator. This came to my attention last night. Texas Gas, as you know, is headquartered in Owensboro, KY. And it is one of the larger corporations in the State of Kentucky. And they are now a part of the CSX family as a consequence of a merger which occurred in August 1983 when they were the target of a takeover by Coastal Corp. I think they feel they have found a better home and they would like to keep it. And they would like to see a parent that has a good earnings statement and the ability to survive as a strong and healthy corporation.

I checked with the people in Owensboro, and Mr. Ted Smith, who is senior vice president there, and Ted told me there had been a number of inquiries from employees in Owensboro about what they can do in light of the threat to CSX which the NS/Conrail merger posed.

They asked Ted to give them some advice on how to proceed and how to make contacts with Senators and Congressmen and he obliged them.

Senator McCONNELL. So it is the policy of the corporation to supply not only the draft but the postage.

Mr. SNOW. Well, it is not a policy, Senator. This was an effort to accommodate the employees who were anxious to find out how to contact you.

Senator McCONNELL. Well, you will be pleased to know that plenty of them have.

You have indicated repeatedly that the merger would force CSX to curtail its operations and lay off thousands of employees. I am wondering if there is no room to improve the efficiency of CSX to meet the increased competition of this new merged line.

Mr. SNOW. Senator, we are not talking about abandoning significant quantities of line as a threat. The B&O Railroad today with revenues of about $1 billion has earnings of only about $30 million on average for the last 3years. That is a very inadequate return on the $2 billion of assets.

We think the B&O outside of this external threat created by NS/Conrail will survive and will be a strong competitor on east-west traffic. But the fact of the matter is that with the market power that will be created if this merger is allowed to go through at many, many points we will be closed out of the routings.

Coal traffic moving off the B&O to the utility plants in Conrail territory will be foreclosed to us through gateway maneuvers. And as that traffic disappears, the viability of the B&O Railroad as an east-west carrier is severely threatened. And that is the source of the potential layoffs and it is the concern that our employees have about their jobs, frankly.

It is not meant as a threat at all. It is meant as a statement of the reality of the situation.

Senator McCONNELL. How many employees do you estimate will lose their jobs, then?

Mr. SNOW. Well, and B&O—as many as 10,000 to 15,000 B&O and Chessie employees, their jobs could be at stake on a base of about 40,000.

Senator McCONNELL. There has been some suggestion, I guess by you or those in the company, that you would have to close the Raceland yard in Greenup County, and it seems to me that that was suggested last fall before the sale.

Mr. SNOW. Senator, we have not said we would close the Raceland shop, but obviously if the coal we are moving today is diverted, as it surely would be, Conrail has 39 utilities in its territory that it serves exclusively. Once Conrail is married with Norfolk Southern, coal which we move from Kentucky and West Virginia into those utilities will be closed off to us.

As we lose that coal business obviously we are going to have need for fewer hopper car repairs. Raceland is our major hopper car repair and building facility. So it would obviously affect employment at Raceland.

Senator McCONNELL. I guess my question was that there was some thought that that would be closed or at least pared back before the sale, though, right? You are just saying the sale would make that more likely.

Mr. SNOW. Senator, Raceland is a good and efficient car shop, and it, like all other facilities, responds to demand conditions. When demand is up, we are building a lot more hopper cars and when demand is down we are building fewer. So that employment levels vary at the Raceland car shops. What I am saying is that if NS and Conrail are allowed to merge we will suffer very significant diversion of coal traffic, which will mean a lower level of employment at the Raceland car shops because we will have fewer cars to repair. We will be hauling less coal, significantly less coal.

Senator McCONNELL. So in terms of lost jobs in my State of Kentucky, do you have an estimated number of jobs that would be lost?

Mr. SNOW. I do, Senator. I think it was several thousand jobs, potential loss of jobs in Kentucky over time.

Senator McCONNELL. Over time.

Mr. Wilson, what were Conrail's earnings in January and February of this year and how do these earnings compare with your projections?

Mr. WILSON. Senator, we do not make public our monthly earnings figures. We will make public our earnings for the first quarter. As the Senator is aware, even the U.S. Government is missing these days—the flash forecast was revised downward to 2.1 from 4.3 percent, which was the expected forecast, and that is the one we used in projecting our revenues. So our revenues were off, and I would not be surprised if we did not miss our budgetary target for the first quarter, but it is not going to be anything that is going to be disastrous. We do not look for it to be long term.

Senator McCONNELL. Is there not a pretty good chance that Conrail's earnings peaked in 1984?

Mr. WILSON. They may have peaked in the sense that for 6 months of 1984, for example, we had a 12 percent wage concession which our employees granted and all the employees of Conrail took in 1981 as part of our effort—management and labor together—to make Conrail a profitable, viable company. We still had that in 1984 for 6 months. We have since restored the wages for all but one of our unions retroactive to July 1, 1984, and we had booked that for the second half of 1984.

The other thing that will be a factor is that, pursuant to the NRSA legislation, we did not pay State taxes in 1984.

If you knock those two things out of our 1984 earnings, our projected earnings for 1985 on the same basis will certainly be comparable.

Senator McCONNELL. So your projections do not show a decline in traffic in the next 2 or 3 years?

Mr. WILSON. Our projections do not show a traffic decline for 1985. When we put together our 5-year plan, which was in June of 1984, the general forecast was for a fairly severe recession in 1986. We took that into account, as forecasters do, and projected a recessionary decline and then a partial recovery in 1987 and a full recovery in 1988.

The hope now, and the expectation of a significant number of economists is, that we are not going to have a severe recession in 1986. I hope we do not.

Senator McConnell. I hope we do not, too. Thank you very much, Mr. Chairman. I appreciate your allowing me to go ahead.

The Chairman. Mr. Wilson, I have a few questions here for each one of you.

In your written statement you suggested that the antitrust review performed by the Justice Department at the request of the Department of Transportation is different from the antitrust review the Justice Department usually performs as a competition advocate. Could you explain the differences?

Mr. Wilson. Yes, sir. When you compare the written letter opinion of the Department of Justice to the Department of Transportation with such things as the filings of the Department of Justice in the Southern Pacific/Santa Fe merger case and with their filings in the other significant merger cases which have come before the Interstate Commerce Commission in the last 4 or 5 years—and that includes the CSX case, the Norfolk Southern case, the UP/MoPac merger—all Justice did in the Conrail/NS situation was to analyze the head-to-head competition which exists between Norfolk Southern and Conrail. There is no mention in the Justice letter to DOT of source competition. There is no mention in that letter about the effect on what we call national market competition, where Conrail competes with the Norfolk Southern because our respective shippers compete ultimately with each other with respect to the end product. There is no mention of the Department of Justice's own guideline that it will look especially askance at a merger which eliminates what has been a significantly disruptive competitive influence in the marketplace. We at Conrail think we have been such a force in the market, and we think that some of our competitors think we have been that, too.

We have been at the forefront of moving the rail industry toward deregulation in the 1980's. So what we find in that letter is very different than what we find in the Southern Pacific/Santa Fe testimony. The absence of any analysis of source competition is very troubling to us.

It is almost as if the Department instead of playing its normal role of prosecutor and investigator of questionable transactions, were acting as the antitrust counselor to the Department of Transportation.

It is as if somebody comes to me and says, Mr. Wilson, I want to put these two companies together. I look at him and say the Department of Justice will never let you do that. He looks at me and he says that is not what I asked you. I want to put these two companies together and I want you to tell me what is the minimum I can do to make the merger palatable to the Department of Justice.

It appears to me that that is the kind of analysis that you have here rather than the detailed, factual analysis which the Department puts together in a merger case which it is going to take to court or in a rail merger case where it is going to appear before the ICC.

And on those facts, Senator, on that kind of analysis, you are being asked to grant antitrust immunity. Somehow people think that Conrail is somehow kind of special. It may be special to us, but when it comes to the effect upon competition and its elimination, it is not special. It should be the same as any other merger case.

I put together this chart to indicate in another context the significance of what the Congress is being asked to do with a grant of antitrust immunity. The green is the Burlington Northern and the red is the UP. If you merged those two railroads it would be about the same size as Conrail/NS. It would be about the same in revenues, slightly higher in profits.

I venture to say that if those two railroads entered into a merger agreement and came before this Congress and asked to be permitted to merge without ICC hearings and to have the Congress grant them antitrust immunity—maybe they would divest a few ailing lines—low density lines—to smaller carriers. If they asked you to bless that with antitrust immunity without any more scrutiny than this transaction has had, I suspect the answer by the Congress would be a resounding no, because that kind of immunity has no precedent.

The CHAIRMAN. Mr. Wilson, you mentioned that Conrail has been an innovative competitor. Would not Norfolk Southern have an incentive to compete just as aggressively in the area now served by Conrail?

Mr. WILSON. Senator, we have been an aggressive and innovative competitor and the reason we have been that is the pressure of competition. Competition is what makes you innovate. We had competition for our automobile plant business—moving auto parts around for the automobile companies.

We had competitive pressure to establish a "just in time" service. They put the inventory in the boxcar at one plant, and it moves to the next plant just in time for that day's production. A lot of people said railroads could not do that. But Conrail did it, and no other railroad has done it to the extent we have.

No other railroad has pulled out of the rate bureaus and is attempting to price independently. No other railroad is exerting the kind of pressure to move the industry into a competitive world in the 1980's that Conrail is. That is what I meant by Conrail being an aggressive competitor. We are responding to the market.

When a company has market power you do not have to do that. The market power, I suggest, of the Norfolk Southern/Conrail combination would be fairly awesome.

The CHAIRMAN. I believe you have suggested that the rail lines that will be divested to the Pittsburgh and Lake Erie Railroad and the Guilford Railroad would be an inadequate substitute for the merger. What rail lines do you believe could be divested to leave both Norfolk Southern and the smaller railroads buying the lines in the strongest position?

Mr. WILSON. Mr. Chairman, if you are asking me to design a divestiture with which I would feel comfortable in my former role as an antitrust enforcer, which I could be sure would be a successful competitor in the Northeast and the Midwest, I think my answer would be that you do not put Conrail and NS together at all. NS is a successful competitor. Conrail is a successful competitor.

For the first time in 25 years the Northeast-Midwest rail system is working, and it really does not seem to make much sense at this time to devise a transaction by divesting a few small lines and redrawing the map. If we do that, then I guess we will see if it works again.

I gather that Mr. Claytor said that he expected the diverted traffic—the amount of traffic to be diverted by these divested lines—would be in the neighborhood of $100 million.

If that is true, let me remind you that that means, on last year's numbers, the revenues of the Norfolk Southern/Conrail combined system would have gone down from $6.8 to $6.7 billion.

The CHAIRMAN. Do you believe that there are procompetitive efficiency gains produced by the Norfolk Southern and Conrail merger?

Mr. WILSON. There may be some efficiency gains which are produced, but I do not think they are efficiency gains which could not be realized by other arrangements between the railroads which did not involve a merger. Interestingly enough, the same kind of efficiency gains were claimed for the Southern Pacific/Santa Fe merger before the ICC, and the Department's economist, Dr. Harris, I believe his name is, came out and said they can achieve virtually all of those efficiencies by arrangements other than merger.

Merger is permanent. It eliminates competition forever. And if it is going to be a bad solution, it is a bad solution forever.

The CHAIRMAN. In your written statement you expressed concern about immunity from private suits being conferred on this merger if it is approved by Congress. As a former Antitrust Division official, do you have an estimate of the number of times a private suit has been filed against a merger after the Department of Justice has worked out a divestiture that eschews a large portion of the competitive problems?

Mr. WILSON. I know there have been some, Senator, but I do not have any that come to mind. I woulld be perfectly happy to do some research on that, but I know there have been some. The real point is that whatever the Department of Justice does—and I know there have been a considerable number of merger suits filed where the Department of Justice has concluded that it is not going to file suit—private parties are not precluded from filing antitrust cases.

Indeed, that is one of the strengths of our antitrust laws. As you know, we have a private enforcement mechanism and we do not have to rely entirely upon the Government and whoever happens to be inhabiting the third floor at 10th and Constitution at any given moment.

The CHAIRMAN. In your written statement I believe you criticized the provision of the sale requiring Norfolk-Southern to maintain or reestablish some joint rates and to provide access to other carriers. Are not these measures designed to protect other railroads from losing business to the Norfolk Southern system?

Mr. WILSON. Senator, that is a very innocuous looking phrase in the memorandum of intent, and let me tell you what I fear that phrase means. If you think back to the pre-Staggers Act days, what you had was a system of equalized, joint rates. However you went from Boston to New Orleans—I use that example because I happen to know because somebody once counted them for me and there were 837 different railroad routes from Boston to New Orleans—and no matter how you went from Boston to New Orleans you paid the same price. If railroads are going to compete effectively in the 1980's, we have to be able to price independently so as to concentrate traffic on efficient routes. Now, that does not mean that I do not have efficient routes on which I have rates with other railroads. The simple question that we ask ourselves is can another railroad do it more efficiently than I can. If he can, then I am going to buy it from him rather than do it myself, because we will both be better off.

What I am afraid that that little phrase means is that we are going to go back to a system of equalized joint rates, equalized rates over all routes between two points. If we go back to that system—we all know how well the railroads were doing in the late seventies, and they were not doing very well at all—the railroads probably will not do well again.

Since the Staggers Act and since we have the freedom to price independently and since we have been doing it, especially at Conrail, I think the whole industry has been doing a lot better.

The CHAIRMAN. Thank you. Mr. Snow, you mentioned that mergers sometimes produced competitive benefits by allowing more efficient operations and better service. Even though there are some negative effects of the Norfolk-Southern and Conrail merger, do you not see any beneficial effects?

Mr. SNOW. I think there are some beneficial effects for Norfolk-Southern, Senator, considerable benefits for Norfolk-Southern. I do not think that there are very many benefits for shippers or the communities which Norfolk Southern/Conrail will serve, but certainly there are some efficiency gains, not gigantic, but not de minimi either, which Norfolk-Southern—and they are a good railroad and run a good railroad—will receive from this meter. Now, I grant you there are some cost savings they will receive, and that is reflected in the displaced employees and the yard consolidations and the abandoned lines that are part of this transaction.

The CHAIRMAN. I believe you mentioned that after the merger traffic may be diverted from other lines onto Norfolk-Southern lines. Is that diversion sometimes beneficial to consumers or would not Norfolk-Southern's rates be lower after the diversion?

Mr. SNOW. Senator, diversion is a good thing and is a measure of efficiency when it is the product of balanced competition. When, as would be the case here, it is entirely the product of the exercise of raw market power, the sort of market power that no district court in this country would ever allow if this were a Clayton antitust case, I think it is a bad thing and a harmful thing.

The CHAIRMAN. I believe you have criticized the fact that this sale was not submitted to the Interstate Commerce Commission for review, which would take longer than a Justice Department review. Is it possible that after a longer period of review the price that a buyer is willing to pay for Conrail would be lower than that that would be paid today?

Mr. SNOW. Senator, I do not know about the price effects, and I am not really critical of the fact it did not go to the ICC. I am critical of the way the Antitrust Division looked at it because you can hardly escape the conclusion that the antitrust analysis was written to support a predetermined outcome rather than the sort of independent, hard headed analysis that the Antitrust Division normally does.

I am not advocating an ICC review for the sake of delay. I think given the way the Antitrust Division has looked at thing it is not credible to think that they can do the sort of analysis, that they bring the sort of objective analysis to it which is needed to determine, for instance, whether the antitrust antidoe, Guilford and P&LE is credible.

So it is for that reason that I would recommend ICC or some other objective, independent agency take a look at it because, Senator, if this transaction goes through, there will never again be an opportunity to look at it. Once this ship leaves port it is never coming back, and nobody will ever have a chance to look at it again. And if it is not anticompetitive then I would ask the Norfolk-Southern and I would ask the Antitrust Division why in heaven's name is the antitrust immunity required. Why not just let it go forward and make it subject to the standard antitrust laws so that people who are adversely affected can bring suits in district courts; because if Mr. McGrath is as good as his word and if he truly feels that this transaction does not raise any competitive problems, why in heaven's name does there have to be an antitrust immunity associated with it?

The CHAIRMAN. You mentioned the low traffic volumes on the rail lines that the Norfolk-Southern would sell off. In what ways can traffic be built up on those lines through competition if they are owned by another railroad?

Mr. SNOW. Senator, I do not think that there will be enough traffic on those lines even at the $100 million level, which is Mr. Claytor's estimate, and I think he is probably not understanding—not highballing that number. Even at his number of $100 million it is highly unlikely that Guilford could be an effective and viable competitor when you face the fact that the capital expenditures on that line required to make it a serviceable route in competition with NS/Conrail probably are more on the order of $200 million.

The CHAIRMAN. Thank you. Mr. Burdakin, I have a few questions here I want to propound to you. I believe you mentioned the Grand Trunk Railroad's proposal to the Department of Transportation to purchase certain rail lines as part of a divestiture plan. How did you select those lines and what happened to those negotiations? Was the price being offered by Grand Trunk a factor in ending the negotiations?

Mr. BURDAKIN. First, how did we arrive at this: we looked at what would be a product that we could sell our customers. And a good share of my business is the automotive business, which is very time sensitive. We came with a network of rail lines that would meet, in our opinion, what the Justice Department said was necessary in order to allow Conrail to be sold to NS.

We had discussions with the Department of Transportation and the Federal Railroad Administration; at the same time Norfolk Southern realizing the decision and the recommendations made by the Department of Justice put together a group of lines which for one reason or another they felt would be competitive and meet the requirements and which that they proposed to sell.

They did not basically come to us with that. They went to Guilford who accepted those lines as they were. Those lines were not, in our opinion, competitive. We do not believe that—they are circuitous. They are of low density. There is not sufficient traffic on the lines and I am talking from my area, from Detroit west. And we just did not feel that those lines met what Mr. McGrath wrote in his letter.

We did not talk about price. We never got to that stage. They offered us trackage rights and traffic rights on a track which will get us to St. Louis 20 hours after the competition. That is a product that I cannot sell.

As far as what we are proposing now, we are saying that if they put those 900 miles together we will have a long term, viable, competitive system, and we are willing to pay for that. Price is not one that we have really addressed. We just assumed that we would pay pro rata of what NS is buying Conrail from the U.S. Government for. I see no reason because of Mr. McGrath's letter that NS should make a windfall.

And I think the U.S. Government could see the same reasoning unless the windfall fell back into the Government. So as a result of that we have not got into price at this point. We have just proposed that we want to sit down and negotiate this. We have a group of investors that are willing to go forward with this, and we think we can make a competitive alternative to fulfill what Mr. McGrath has requested DOT to do.

The CHAIRMAN. Could you describe the adverse effects of the Norfolk Southern/Conrail merger that will occur in the State of Michigan.

Mr. BURDAKIN. The impact of that will be on the other lines in Michigan, the biggest of which will be myself because the amount that Mr. Snow gets out of Michigan proportionately to his total revenue is nowhere near like the 50 percent of the automobile traffic, et cetera, that I have.

There are 50,000 carloads of traffic that we believe will within 3 years be diverted from Grand Trunk to NS/Conrail combined. We do not concur with Mr. Claytor's feeling that just keeping the routes open and the discussion about why routes are opening; it is really not a major effort today. We have to have the ability and the market and the market power. We believe that that 50,000 carloads are going to leave us.

There is absolutely no way that I can make up that revenue. There is nothing that I can foresee happening, unless Michigan for some reason develops 30 feet of coal under the entire State, there is no way I can make that revenue up. There is only one thing that happens when revenue is less than the cost of doing business, and that is a deterioration of the railroad and a deterioration of the service, and Conrail and Penn Central went through that period and I do not want to go it again. I was there at that time and I do not want to do it again with Grand Trunk and I do not think it is necessary and I think the Congress should protect the competitive aspect of the rail network in this area of the country.

The CHAIRMAN. Mr. Burdakin, you mentioned a need for access by small regional railroads to the divestiture area. Can you explain why this access is important to competition and why you think the divestiture plan offers inadequate access.

Mr. **Burdakin**. The need is because of this item of market power that has been expressed by my cohorts here. The ability of a large railroad to use its size and its distance to control and to adjust rates is just tremendous today under deregulation.

The ability to close off gateways and say I will not take that car at that interchange anymore, and we have had a great deal of this with Conrail. For example, we used to get a tremendous amount of business that came from Chicago to Buffalo and the Niagara frontier and gave it to Conrail at Buffalo going into the eastern markets. They say we do not want it there. You give it to us at Chicago or you do not give it to us at all. And the customer has no alternative.

The result of that is that Grand Trunk just cannot compete because it is small.

The market power of these large systems are squeezing these small regional railroads, and the Pittsburgh-Lake Erie's income statement for the last 2 or 3 years is an indication of this as well as my own income statement. The market power that is allowed under deregulation is just tremendous in this industry today.

The **Chairman**. Mr. Burdakin, how can a railroad turn low density rail lines into competitive and profitable lines and in what ways can a regional railroad build up its traffic volume and its business?

Mr. **Burdakin**. Well, I have been very successful in being responsive to the needs of my customers. I think that we have a great deal of respect in being able to fulfill what the customer wants, when he wants service, when he wants those cars placed against his dock for loading or when he wants them placed against the dock for unloading; the other aspects that go with it, the claims, the claim prevention, the courtesy, the responsiveness to rates or to changes, the suggestion of changes, some of which we have done.

We can do that. We can compete. We can compete on a fair and equal basis. But when you get the huge systems just saying that we will not let you compete, that is where we have a problem. And that will occur when NS/Conrail get together.

The **Chairman**. I think that completes the questions that I had to ask you gentlemen. We want to thank you for your testimony and your presence here today.

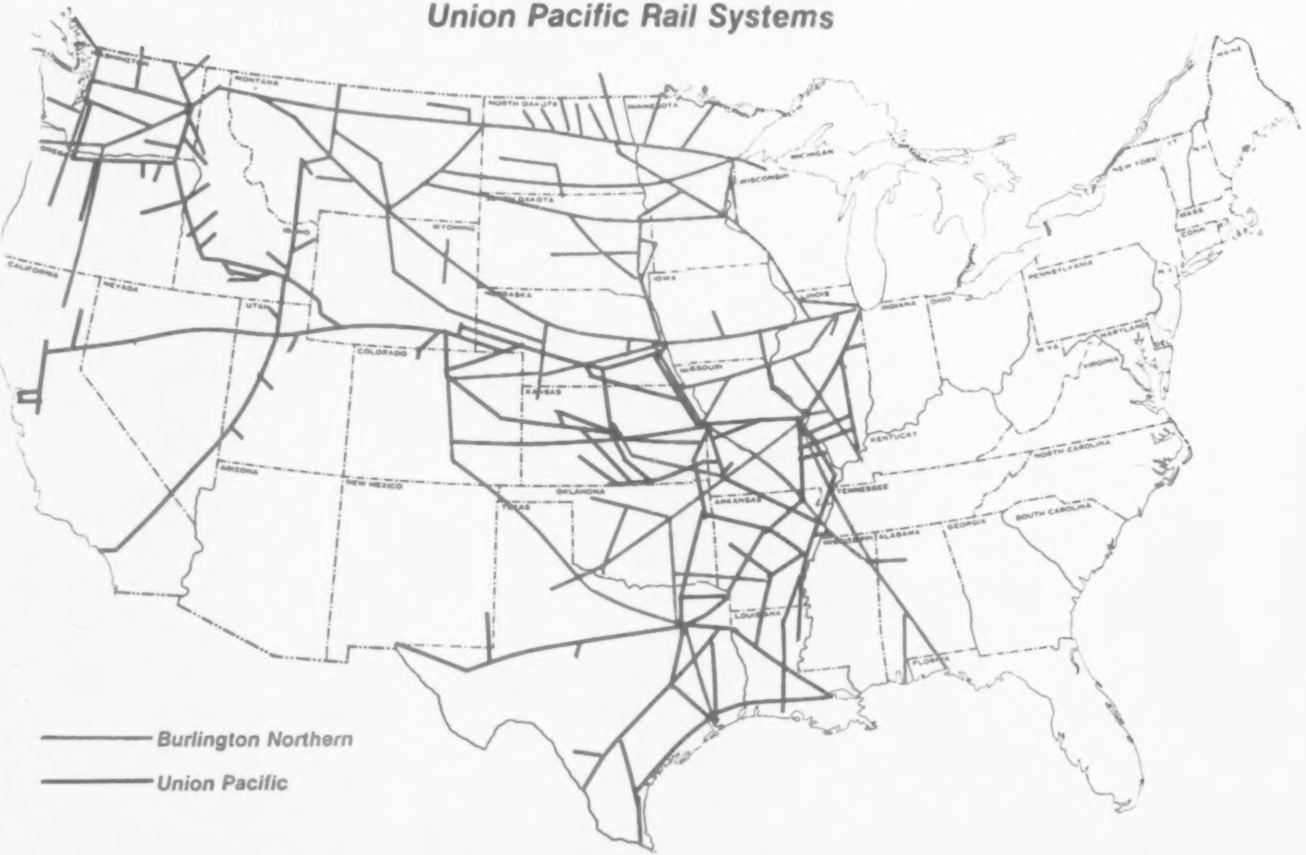
Mr. **Wilson**. Mr. Chairman, so that people can understand what we were talking about when we were referring to the map, might I request that it be made a part of the record?

The **Chairman**. Without objection, that will be made a part of the record.

Mr. **Wilson**. Thank you.

[The information follows:]

Overlap of Burlington Northern and Union Pacific Rail Systems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Burlington Northern
Union Pacific

The **Chairman**. Now, we have two witnesses left today; Mr. Rooney from the Federal Railroad Administration, and Mr. Ross with the U.S. Department of the Treasury. Mr. Rooney and Mr. Ross.

Senator Metzenbaum had to leave, and he has requested that these two witnesses be held over until next Tuesday, I believe, the 2nd of April.

Would that inconvenience you, gentlemen?

Mr. **Rooney**. Mr. Chairman, I have a budget hearing which I will try to work my way out of. I will call your staff back and let them know whether I can make that date. But, in any event, I think we could probably present a witness at that time.

Mr. **Ross**. Yes, Mr. Chairman, I can make that date.

The **Chairman**. I think it might be better if they are here rather than have questions raised later.

Senator Specter, too, had to be away this afternoon.

I do not know why they arranged to be away. They both knew this hearing was going on, but they had engagements I guess they could not rearrange.

Mr. **Rooney**. My assistant informs me that we are running out of bodies. I will get back very quickly and tell your staff whether that date is going to be an agreeable situation.

The **Chairman**. We have got it set for next Tuesday, and that is the only other day we will have.

Mr. **Rooney**. Let us make the presumption that we can work with that situation.

The **Chairman**. And if you cannot work it out, we better take you now, but, if you can, I think it will be better to be here when these other gentlemen could examine you for the record.

Mr. **Rooney**. I think we can make a better record at that time, Senator. I agree with you. If you would like to do it that way, I will make every effort to make that.

The **Chairman**. All right. We will count on you again next Tuesday.

Now I have a letter here I think I had better put in the record from Mr. McGrath. It is addressed to me, and says:

> Dear Senator Thurmond: At the hearing on this subject this morning, the question was raised whether the law firm I will return to next week, Dewey, Ballantine, Bushby, Palmer and Wood, has been retained by Norfolk and Southern to do tax lobbying work. As I indicated at the hearing, I had not heard previously about any such representations nor have I discussed the Norfolk and Southern matter with anyone at Dewey, Ballantine. After the hearing, my special assistant, Ms. Deborah Garza, contacted Mr. Salmon at Dewey, Ballantine, and learned from her that in early March he was retained to do tax lobbying for Norfolk Southern. Apparently he had not realized at the time that I was involved in the matter. I would have spoken to the Department of Transportation on this matter had it been submitted in January. In any event, in accord with my usual disqualifying policy, I have disqualified myself from any further involvement in the Department of Justice consideration of the proposed sale of Conrail.

And that is signed by J. Paul McGrath, Assistant Attorney General, Antitrust Division.

I will send Attorney General, Mr. Meese, a copy of that letter for his consideration and appropriate action, if any.

Is any other matter coming before us this afternoon?

All the members, I believe, have gone.

I want to thank all of you gentlemen for your appearance here today and for your testimony. And next Tuesday we will continue at 10 o'clock with this hearing.

[The following was received for the record:]

RICHMOND, FREDERICKSBURG AND POTOMAC RAILROAD COMPANY
P.O. BOX 11281 RICHMOND, VIRGINIA 23230
TELEPHONE: (804) 257-3235

URCHIE B. ELLIS
Vice President—Law

CHARLES A. HARTZ, JR.
General Attorney

SUSAN H. PIERCE
Attorney

March 25, 1985

The Honorable Strom Thurmond
Chairman
Senate Committee on Judiciary
Dirkson Building, Room 226
Washington, D. C. 20510

Re: Acquisition of Conrail by Norfolk Southern

Dear Senator Thurmond:

In connection with hearings to be conducted on March 27 by your Committee, I attach copy of Statement of this Company in opposition to the acquisition of Conrail by Norfolk Southern. This same Statement was supplied to the Senate Committee on Commerce, Science and Transportation in connection with its hearings on February 27 and 28.

The Statement of this Company presents a different perspective and a particular anti-trust problem.

Copies are being supplied to Mr. Starling for appropriate distribution to the other members of the Committee and the Committee staff. Thank you.

Respectfully yours,

Urchie B. Ellis

UBE/dj

Attachment

cc: Mr. Kenneth Starling
Antitrust Counsel
Senate Committee on Judiciary
Dirkson Building, Room 226
Washington, D. C. 20510

STREET ADDRESS 2134 WEST LABURNUM AVENUE RICHMOND, VIRGINIA 23227

Before the Senate Committee
on Judiciary
Hearing Scheduled March 27, 1985
(This same Statement presented to
the Senate Committee on Commerce,
Science and Transportation in
connection with hearings on
February 27 and 28, 1985.)

STATEMENT ON BEHALF OF RICHMOND, FREDERICKSBURG AND POTOMAC RAILROAD COMPANY IN OPPOSITION TO THE PROPOSED SALE OF CONRAIL TO NORFOLK SOUTHERN

Mr. Chairman and Members of the Committee:

My name is John J. Newbauer, Jr. and I am President of the Richmond, Fredericksburg and Potomac Railroad Company (RF&P), with offices in Richmond, Virginia (Post Office Box 11281, Richmond, Virginia 23230, Phone: 804-257-3221).

RF&P has been in existence for more than 150 years, and has long been a major participant in the north/south traffic in the eastern part of the United States, serving as a connecting railroad between Conrail (formerly Pennsylvania Railroad and Penn Central Railroad) on the north, and Seaboard System (and its predecessor railroads Atlantic Coast Line and Seaboard Air Line) on the south. This traffic is in large part highly competitive and, when routed through the Potomac Yard Gateway in Northern Virginia, can move between Conrail and points in the south and southeast by way of either RF&P - Seaboard, or by way of Southern Railway. Competition with Southern Railway has long been vigorous. If Norfolk Southern is allowed to acquire control of Conrail, it is obvious that this competition will be severely impacted because Norfolk Southern will insist that the Conrail traffic be preferentially routed via Southern Railway at Potomac Yard (or via Hagerstown, Maryland - N&W). This will have a serious adverse impact upon the RF&P, and will offend antitrust and monopoly concepts.

The relationship of RF&P in a proposed Norfolk Southern - Conrail alignment, and an analysis of north/south traffic have apparently received little consideration to date. RF&P feels it is of such significant importance that its participation in this large proceeding is justified. For the reasons mentioned, RF&P

is strongly opposed to the acquisition of Conrail by Norfolk Southern; however, if such acquisition is approved by Congress, then we believe the contract of sale between the United States and Norfolk Southern must include some conditions (in addition to those recently proposed by the Antitrust Division of the Department of Justice in its letter of January 29, 1985 to Secretary Dole), which additional conditions would relate specifically to the RF&P and north/south traffic, and would require generally as follows:

1. That Norfolk Southern - Conrail would be obligated to continue rates and routes on traffic involving Conrail via RF&P through the Potomac Yard Gateway to and from competitive points throughout the south. Such condition would require that RF&P and its connecting railroads to the south be allowed to participate in any rates published, or contracts made by Conrail, on any traffic at the same level of charges and subject to the same rules and conditions as would be applicable if the traffic was routed via Southern Railway to and from Potomac Yard, (or via the Hagerstown - N&W route). Such arrangements should be subject to divisions between Conrail, RF&P and other involved railroads on formula or basis comparable to those presently used.

2. RF&P should be given the opportunity to acquire trackage rights between Potomac Yard (in Alexandria/ Arlington, Virginia) and the New York area via the Corridor. In addition, appropriate arrangements should be made, via trackage rights or other suitable means, for the interchange of traffic between RF&P at Potomac Yard and "Prorail" (which has been mentioned in the media), or any other such competitive rail system that evolves from or is created as result of the sale of Conrail, such point of interchange to be at Potomac Yard if possible, or at the closest point at which it is operationally feasible to make such interchange.

The following is offered in justification and explanation of the RF&P position and request for conditions:

RF&P was incorporated in the State of Virginia in 1834, and has had its offices in the City of Richmond and has been functioning as a separate railroad during its existence.

RF&P operates between Richmond, Virginia and Washington, D. C., approximately 110 miles, with a fully signaled, modern, heavy-duty double track mainline. RF&P uses its own locomotives and operates the trains over its line, both freight and passenger. It owns numerous railroad cars, and has approximately 850 employees.

RF&P owns and operates the large Potomac Yard freight classification facility in Arlington and Alexandria, Virginia. This yard is unique in that it provides services for six different railroads through one organization - those railroads are: RF&P, Southern Railway, Baltimore & Ohio, Chesapeake & Ohio, Conrail, and Delaware & Hudson. Each of those railroads operates its own trains in and out of Potomac Yard with its own locomotives, crews, etc.

In the calendar year 1984, the RF&P railway operating revenues as reported in its Annual Report were $57,450,000. (The RF&P Annual Report for the year 1984 will supply further details - copy available upon request - copies supplied to Committee staff.)

The competitive situation between the RF&P - Seaboard route and Southern Railway on traffic via Potomac Yard to and from Conrail and points in the south and southeast is indicated by the attached small maps from *The Official Railway Guide* showing:

A) The RF&P (and some of its freight train schedules) and Seaboard System Railroad territories; and

B) The Southern Railway territory.

A quick comparison makes it clear that the Southern Railway and Seaboard territories overlap extensively. They jointly serve numerous major cities throughout the south, and of course have connecting smaller railroads to other locations. From this it should be clear that the routes to and from Conrail via RF&P (and its connections with Seaboard and others to the south) are very competitive on nearly all traffic with the routes via Southern Railway through Potomac Yard.

Traffic to and from Conrail could also move via the Hagerstown, Maryland - Norfolk & Western route connection with Conrail and to and from points within the southeast, again in vigorous competition with the RF&P route. The route and rate protection requested by RF&P should also cover this possibility.

We can illustrate the vigorous degree of competition by calling attention to specific problems and solutions which have arisen in the past several years. In 1982 Conrail advised RF&P and Seaboard that it was losing $1,200,000 per year on certain traffic moving via RF&P - Seaboard through Potomac yard and via Seaboard over the Cincinnati Gateway, which traffic might otherwise move via Southern Railway (a preponderance of this traffic is calculated to be moving via Potomac Yard). As a result, RF&P and Seaboard jointly agreed to pay Conrail $1,200,000 per year (which has since been increased) to retain this traffic. In turn, Conrail agreed not to discriminate against RF&P and Seaboard in favor of Southern Railway System in connection with rates or traffic solicitation. Another evidence of the competitive nature of the traffic is that Conrail has published various surcharges, and it was necessary that RF&P and Seaboard enter into surcharge absorption tariffs in order to remain competitive. If RF&P does not have rate and route protection, it obviously will not be able to be competitive if Norfolk Southern acquires control of Conrail.

Illustrative of RF&P traffic to and from Conrail or points north thereof, which is directly competitive with Southern Railway and susceptible to diversion, are paper products, pulpboard, chemicals, and piggyback shipments, representing a substantial portion of RF&P annual freight revenues.

In that RF&P is frequently viewed as an affiliate or subsidiary of CSX, we would like to emphasize that our position here is one taken independently by the RF&P management, in the interest of the RF&P as a separate functioning railroad with over

60% of its shareholders having no connection with CSX. Briefly, over 37% of the Company's stock is held by the general public, approximately 20% is held by the Commonwealth of Virginia, and about 8% involves the Southern Railway. CSX by way of C&O, B&O, and Seaboard, owns or controls about 34% of our total outstanding stock, which includes control of approximately 60% of our voting stock by way of the Richmond Washington Company. The latter was created in 1901 to acquire ownership of the RF&P pursuant to an agreement between the then six interested railroads which were Pennsylvania Railroad, C&O, B&O, Southern, Atlantic Coast Line, and Seaboard Air Line. This resulted in the acquisition by Richmond Washington Company of what is now 62.9% of the voting stock of RF&P (voting stock being less than 20% of the total shares outstanding, with the rest being called dividend obligations).

As just mentioned, the views of RF&P being here expressed represent the independent position of this separate Company, and should not be considered to be an adjunct of or supplement to the separate and distinct arguments being advanced by CSX. RF&P is not here to take a position on the several other proposals for the disposition of Conrail, but may do so in the future should it become appropriate.

In conclusion, RF&P is opposed to the acquisition of Conrail by Norfolk Southern because of the potential adverse affects upon RF&P through diversion of traffic, and because of the antitrust - monopolistic concepts involved, but if such acquisition by Norfolk Southern is finally approved, then RF&P requests:

1. Rate and route protection; and

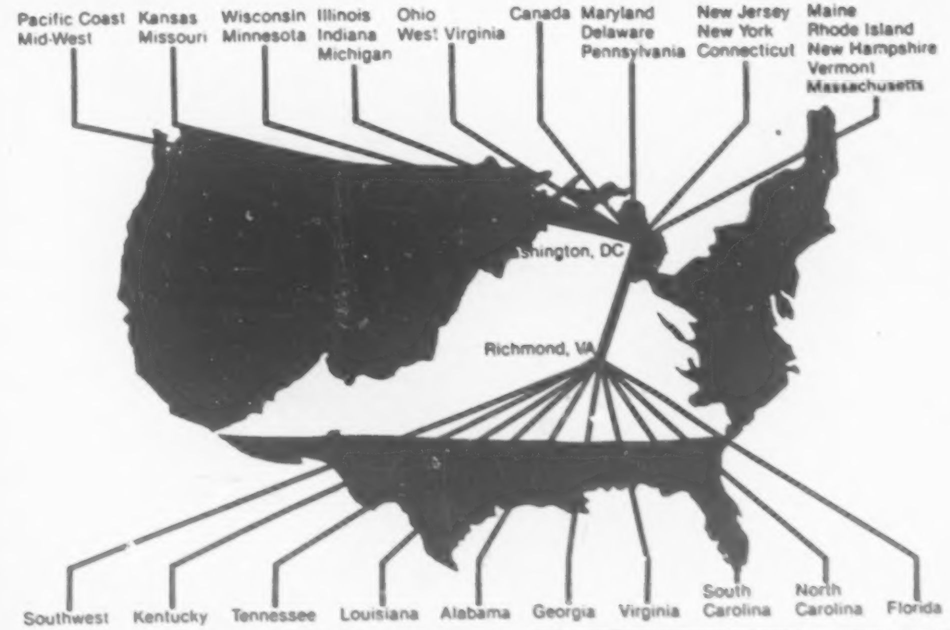
2. The opportunity for RF&P to acquire trackage rights between Potomac Yard and the New York area, and, in addition, the opportunity to interchange traffic, via trackage rights or other means, with "Prorail" or any other such competitive rail system that evolves from CR is created as result of the sale of Conrail.

John J. Newbauer, Jr.
President
Richmond, Fredericksburg and
Potomac Railroad Company
P. O. Box 11281
Richmond, Virginia 23230

8180

RF&P

RICHMOND, FREDERICKSBURG AND POTOMAC RAILROAD COMPANY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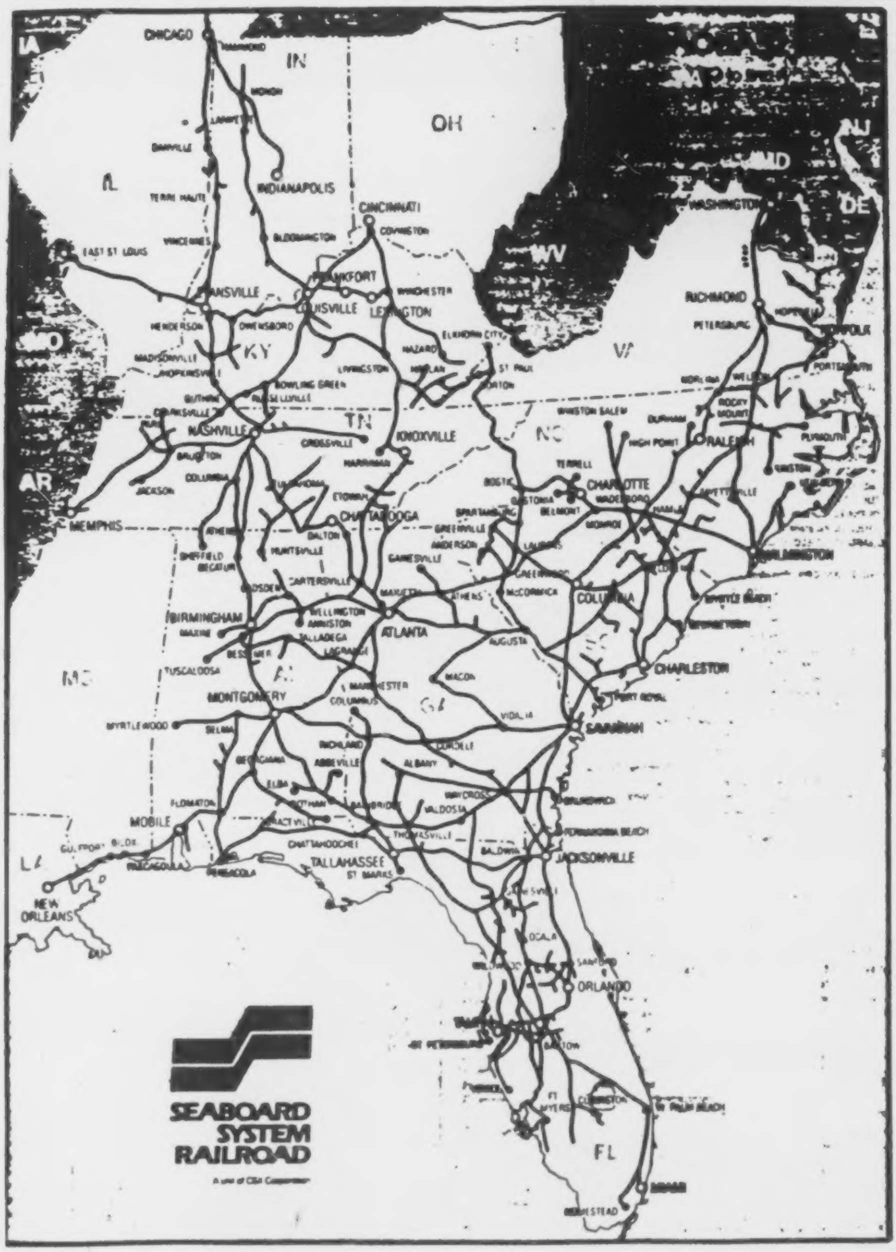
Connecticut
Maine
Rhode Island
New Hampshire
Vermont
Massachusetts
Washington, DC
Richmond, VA
Southwest
Kentucky
Tennessee
Louisiana
Alabama
Georgia
Virginia
South Carolina
North Carolina
Florida

Schedule 1—TOFC THROUGH SCHEDULE

275	175	227	227						176	276	280
Ex W	Ex W	[illegible]	Ex W				Frequency of Operation		Daily	Daily	Daily
				Ep	Mi		CONRAIL				
1900	1900	1900	1900	0	0	Dp	New York, NY (Kearny, NJ)	Ar	0715	0715	
0245	0245	0245	0245	0	0	Ar	Potomac Yard, VA	Dp	2100	2100	
				0	0		BALTIMORE & OHIO				
1700	1700	1700	1700	0	0	Dp	Philadelphia, PA	Ar	0015	0015	
1900	1900	1900	1900	0	0	Dp	Wilmington, DE	Ar	2345	1045	
0245	0245	0245	0245	0	0	Ar	Potomac Yard, VA	Dp	1900	1900	
275	175	227	227				RICHMOND, FREDERICKSBURG & POTOMAC		176	276	280
[1] 0730	[1] 1120	[1] 1130	[2] 1100	0	0	Dp	Potomac Yard, VA	Ar	1215	1415	[illegible]
1015	1400	1400	1320	0	0	Ar	Richmond, VA	Dp	[illegible]	1100	1230
							SEABOARD SYSTEM				
1115		1420	1400	0	0	Dp	Richmond, VA	Ar		1115	[illegible]
1700				0	0	Ar	Raleigh, NC	Dp		[illegible]	[illegible]
0100		0100		0	0	Ar	Charlotte, NC	Dp		[illegible]	
0700		1000	0700	0	0	Ar	Atlanta, GA	Dp		[illegible]	[illegible]
0130		0130		0	0	Ar	Birmingham, AL	Dp		[illegible]	[illegible]
	1430			0	0	Dp	Richmond, VA	Ar	[illegible]		
	0700			0	0	Ar	Jacksonville, FL	Dp	[illegible]		
	0215			0	0	Ar	Orlando, FL	Dp	[illegible]		
	1000			0	0	Ar	Tampa, FL	Dp	[illegible]		
	1400			0	0	Ar	Miami, FL	Dp	2130		

1 —Ramp closes at 0530
2 —Ramp closes at 1000


CHICAGO
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FRANKFORT
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LEXINGTON
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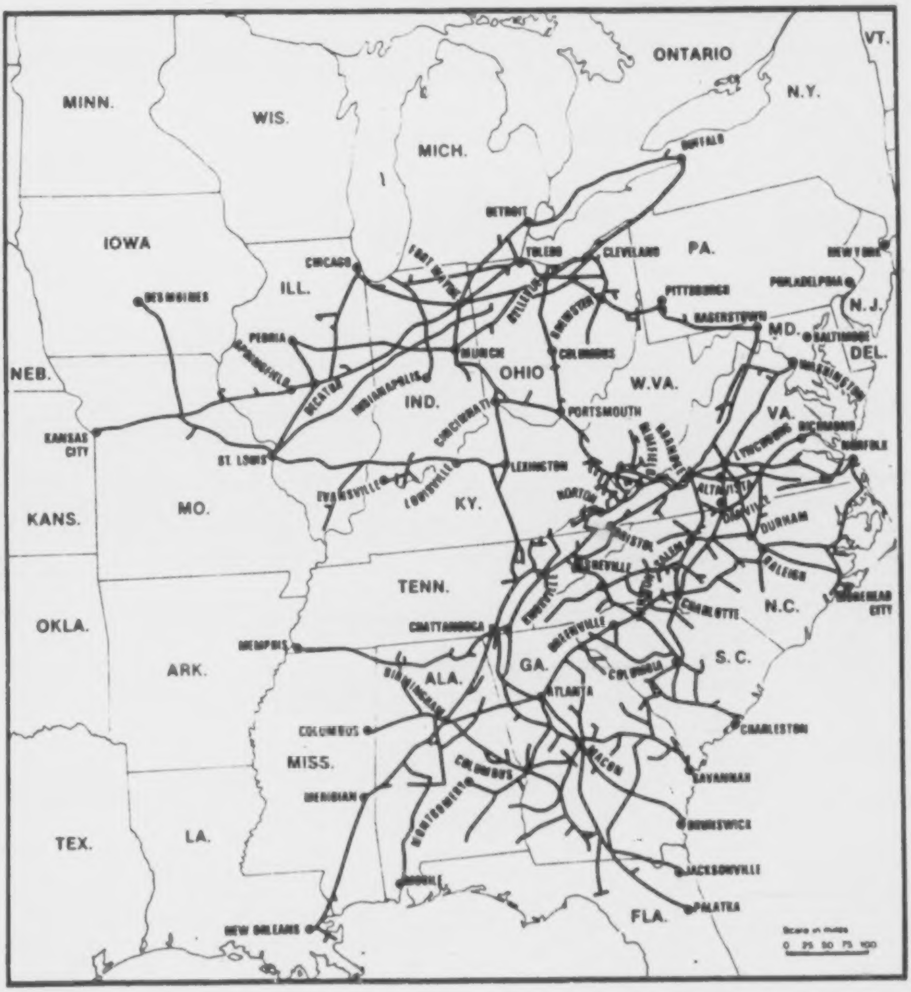
WV
MD
NJ
DE
WASHINGTON
RICHMOND
NORFOLK
VA
MO
TN
NASHVILLE
KNOXVILLE
NC
CHARLOTTE
RALEIGH
AR
MEMPHIS
CHATTANOOGA
WILMINGTON
BIRMINGHAM
ATLANTA
COLUMBIA
SC
CHARLESTON
MS
AL
GA
MONTGOMERY
SAVANNAH
MOBILE
LA
NEW ORLEANS
PENSACOLA
TALLAHASSEE
JACKSONVILLE
ORLANDO
FL
SEABOARD SYSTEM RAILROAD
A unit of CSX Corporation

8144

NS NORFOLK SOUTHERN

Operating Subsidiaries: Norfolk and Western Railway Company
Southern Railway System Companies


ONTARIO
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MICH.
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BUFFALO
DETROIT
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NEW YORK
CHICAGO
FORT WAYNE
ILL.
DES MOINES
PHILADELPHIA
PITTSBURGH
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HAGERSTOWN
MD.
BALTIMORE
PEORIA
SPRINGFIELD
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COLUMBUS
DEL.
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DECATUR
INDIANAPOLIS
OHIO
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WASHINGTON
IND.
PORTSMOUTH
KANSAS CITY
CINCINNATI
VA.
LYNCHBURG
RICHMOND
NORFOLK
ST. LOUIS
LEXINGTON
ALTAVISTA
EVANSVILLE
LOUISVILLE
NORTON
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DANVILLE
DURHAM
BRISTOL
RALEIGH
TENN.
N.C.
MOREHEAD CITY
CHARLOTTE
OKLA.
CHATTANOOGA
GREENVILLE
MEMPHIS
ARK.
ALA.
GA.
S.C.
COLUMBIA
BIRMINGHAM
ATLANTA
COLUMBUS
CHARLESTON
MISS.
MACON
COLUMBUS
SAVANNAH
MERIDIAN
MONTGOMERY
BRUNSWICK
TEX.
LA.
JACKSONVILLE
MOBILE
FLA.
PALATKA
NEW ORLEANS
Scale in miles
0 25 50 75 100

10/84

March 27, 1985

Testimony
# of the
Chicago South Shore and South Bend Railroad
before the
Senate Judiciary Committee
on
S. 638 and the Proposed Sale of the Consolidated Rail Corporation

My name is John A. Darling. I am the Chairman and Chief Executive Officer of the Chicago South Shore and South Bend Railroad, a regional railroad located in northern Indiana.

The Chicago South Shore and South Bend Railroad appreciates this opportunity to supplement the Senate Judiciary Committee record on S. 638 and the proposed sale of the Consolidated Rail Corporation's common stock by the Department of Transportation. The South Shore's concerns address the decrease in competition that will occur in St. Joseph County, Indiana, as a result of Conrail's acquisition by the Norfolk Southern. St. Joseph county is one of the several counties the Justice Department determined have a competitive revenue problem of more than $2 million. The Justice Department did not, however, include St. Joseph County as one of the mandatory divestitures listed in that Department's letter to Secretary Dole dated January 29, 1985 (Please see attachment A).

The South Shore is willing and able to purchase Norfolk Southern or Conrail lines in St. Joseph County and thereby preserve the existing level of rail competition in that county. I would emphasize that the South Shore's proposed acquisition would meet all the other standards contained in The Justice Department's letter of January 29, 1985 to Secretary Dole. However, Norfolk Southern has refused to discuss with the South Shore the sale of any lines in St. Joseph County because the latter county is not on the list of mandatory divestitures contained on page 1 of attachment A of Justice Department's January 29 letter. The Norfolk Southern's reluctance to sell any assets beyond those absolutely required is understandable as a matter of Norfolk Southern business strategy. The South Shore does not believe that such a strategy is in the public interest when a competitive problem is a matter of public record.

St. Joseph County includes City of South Bend and is one of the four most populous counties in Indiana. In fact, in total population and number of manufacturing plants, St. Joseph is almost as large as Allen County, Indiana, a county slated for mandatory divestiture. St. Joseph County is an example of how the relatively broad approach to competition by the Justice Department overlooked a possible divestiture to a regional railroad that is commercially and technically feasible. Yet because the DOT-Justice agreement is "cast in stone," there will be no divestitures in St. Joseph County or similar counties unless the Congress so directs. South Shore therefore recommends that the Congress modify the Department of Transportation's bill to provide that as long as the divestiture of additional problem counties meets the standards contained in the Justice Department's letter of January 29, 1985 to Secretary Dole, the Norfolk Southern would be required to do so.

Attachment A

"Divestiture" means the conveyance or other transfer by sale, lease, or otherwise of rail tracks and facilities owned or operated by CR or NS or the right to use such rail tracks and facilities.

"NS" means Norfolk Southern Corporation, its subsidiaries, affiliates, successors and assigns.

"CR" means Consolidated Rail Corporation, its subsidiaries and affiliates.

"CSX" means CSX Corporation, its subsidiaries, affiliates, successors and assigns.

1. This Agreement of Sale is contingent upon prior or concurrent Divestiture sufficient to enable an acquirer or acquirers ("acquirer(s)"), not controlled as control is defined in 49 U.S.C. §10102 by NS/CR or CSX, to provide rail service along a rail corridor bounded on the West by Chicago and E.St. Louis and on the East by Buffalo and Pittsburgh, with service to, from, and between the following counties in that rail corridor: Erie, New York; Cuyahoga, Lorain, Jefferson, Lucas, and Stark, Ohio; and Allen and Marion, Indiana. Subject to the requirements of paragraph (5) with respect to Marion County, Indiana, such rail service may be limited to service along those sold or leased rail lines where prior to divestiture shippers, had service by both NS and CR. Such rail service shall include direct connections in Buffalo, E.St. Louis, Toledo and Chicago to a railroad or railroads not controlled by NS/CR or CSX as control is defined in 49 U.S.C. §10102.

2. The rail tracks, rights and facilities divested pursuant to paragraph (1) and the consideration paid therefor shall be determined by agreement between NS and the acquirer(s).

3. The Divestiture required by paragraph (1) shall be made to acquirer(s) who shall have demonstrated to the Department of Justice that they will be able to provide long-term, viable, competitive rail service along the rail corridor(s) and to, from and between the counties enumerated in paragraph (1), as indicated by their having managerial, operational, and financial capability necessary to compete effectively in the provision of such rail service. The Divestiture required by paragraph (1) may not be accomplished without the prior approval by the Attorney General of its terms and conditions and of the acquirer(s).

4. Following the execution of this Agreement of Sale, NS shall promptly solicit offers to purchase, lease, or operate upon property to be divested in accordance with paragraph (1). NS shall keep records of its efforts to accomplish the Divestiture required by paragraph (1), including the identification of any person or persons expressing an interest to any officer or official of NS, and the terms and conditions of each offer, and shall allow the Department of Justice access to such records. NS shall immediately notify the Department of Justice of the details of any offer related to the Divestiture required by paragraph (1). If NS rejects any such offer, it shall promptly notify the Department of Justice and fully describe the reasons for such rejection.

5. It is further agreed that following Divestiture NS, CR, or NS/CR shall switch cars, on terms and conditions customary at other locations within the region of the Divestiture, between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper physically served by NS, CR, or NS/CR and open to service by both as of the date hereof, at each of the counties specified in paragraph (1) whenever such switching is practicable and necessary in order to provide a shipper with effective competitive access to the tracks and facilities of the acquirer(s). Following Divestiture, in Marion County, Indiana, NS, CR or NS/CR shall establish switching charges at levels no higher than those customarily charged at other locations within the region of the Divestiture for switching cars between the tracks and facilities of the acquirer(s) and the tracks and facilities of any shipper served by NS, CR or NS/CR as of the date hereof. If there is a dispute as to whether such switching is practicable and necessary, or as to such customary conditions and compensation for such switching, such dispute shall be resolved within six months by an arbitration procedure governed by the rules of the American Arbitration Association. In respect of such requirements for practicable and necessary switching of cars, the acquirer(s) and the directly affected shipper(s) shall be entitled to enforce this paragraph, in each such instance, for their sole benefit.

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MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $2 MILLION OR MORE

---------------------------------- ST=AL ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  ORIG    4759    DALLAS    26111    PULP

  ORIG    4783    WILCOX    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD

---------------------------------- ST=AR ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  ORIG    6118    JEFFER    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD

---------------------------------- ST=FL ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  ORIG    4936    TAYLOR    26111    PULP

---------------------------------- ST=GA ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  DEST    4685    DOUGHE    26111    PULP

  ORIG    4655    GLYNN     26311    FIBERBOARD, PAPERBOARD OR PULPBOARD

  ORIG    4637    MACON     26111    PULP

---------------------------------- ST=IL ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  ORIG    3877    CHAMPA    20921    SOYBEAN OIL,CRUDE OR REFINED

  ORIG    3922    MACON     20419    FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
  ORIG    3922    MACON     20463    CORN SUGAR

  DEST    3876    VERMIL    28712    SUPERPHOSPHATE
  DEST    3876    VERMIL    40211    IRON OR STEEL SCRAP,WASTES OR TAILINGS
  ORIG    3876    VERMIL    20413    CORN MEAL OR FLOUR
  ORIG    3876    VERMIL    20419    FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
  ORIG    3876    VERMIL    20923    SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

---------------------------------- ST=IN ----------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

  ORIG    3642    ADAMS     20923    SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE
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MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $1 MILLION OR MORE     .

------------------------------------ ST=IN ------------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

DEST      3618    ALLEN     11212    PREPARED BITUMINOUS COAL
DEST      3618    ALLEN     26311    FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST      3618    ALLEN     26471    SANITARY TISSUES OR HEALTH PRODUCTS
DEST      3618    ALLEN     40211    IRON OR STEEL SCRAP,WASTES OR TAILING
DEST      3618    ALLEN     41114    ARTICLES, USED
ORIG      3618    ALLEN     37149    MOTOR VEHICLE ACCESSORIES OR PARTS,NE
ORIG      3618    ALLEN     40211    IRON OR STEEL SCRAP,WASTES OR TAILING

ORIG      3682    CLINTO    20923    SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

DEST      3687    MARION    11212    PREPARED BITUMINOUS COAL
ORIG      3687    MARION    20411    WHEAT FLOUR
ORIG      3687    MARION    20413    CORN MEAL OR FLOUR
ORIG      3687    MARION    20462    CORN STARCH
ORIG      3687    MARION    20923    SOYBEAN CAKE,FLOUR,GRITS,MEAL OR OTHE

ORIG      3623    ST JOS    37112    MOTOR TRUCKS OR TRUCK TRACTORS,ASSEMB


------------------------------------ ST=KY ------------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

ORIG      2865    JEFFER    28212    SYNTHETIC RUBBERS
ORIG      2865    JEFFER    36321    HOUSEHOLD REFRIGERATORS OR HOME OR FA


------------------------------------ ST=LA ------------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

ORIG      6451    ASCENS    49057    FLAMMABLE COMPRESSED GASES
ORIG      6451    ASCENS    49066    FLAMMABLE LIQUIDS, THERMALLY UNSTABLE


------------------------------------ ST=MA ------------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

DEST      1452    HAMPDE    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD


------------------------------------ ST=MI ------------------------------------

          SPLC    COUNTY    STCC5    PRODUCT

ORIG      3167    INGHAM    37149    MOTOR VEHICLE ACCESSORIES OR PARTS,NE

DEST      3193    KALAMA    26311    FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST      3193    KALAMA    33123    IRON OR STEEL SHEET OR STRIP

ORIG      3194    WASHTE    37149    MOTOR VEHICLE ACCESSORIES OR PARTS,NE
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MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $1 MILLION OR MORE

----------------------------------- ST=MI -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
DEST	3181	WAYNE	20841	WINE,BRANDY OR BRANDY SPIRITS OR FRUI
DEST	3181	WAYNE	26213	PRINTING PAPER,COATED OR UNCOATED,
DEST	3181	WAYNE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
DEST	3181	WAYNE	41114	ARTICLES, USED
ORIG	3181	WAYNE	37111	MOTOR PASSENGER OR AIR CARS,ASSEMBLED
ORIG	3181	WAYNE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
ORIG	3181	WAYNE	41114	ARTICLES, USED
DEST	3183	WAYNE	41114	ARTICLES, USED
ORIG	3183	WAYNE	37111	MOTOR PASSENGER OR AIR CARS,ASSEMBLED
ORIG	3183	WAYNE	37112	MOTOR TRUCKS OR TRUCK TRACTORS,ASSEMB
ORIG	3183	WAYNE	37142	MOTOR VEHICLE ACCESSORIES
ORIG	3183	WAYNE	37147	MOTOR VEHICLE BODY PARTS
ORIG	3183	WAYNE	41114	ARTICLES, USED

----------------------------------- ST=MO -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
DEST	5675	ST LOU	33125	STRUCTURAL SHAPES OR PILING,STEEL MIL
DEST	5675	ST LOU	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE
ORIG	5675	ST LOU	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE

----------------------------------- ST=KS -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
ORIG	4893	ADAMS	26111	PULP

----------------------------------- ST=NC -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
ORIG	4033	WASHIN	24211	LUMBER,ROUGH OR DRESSED,OF SOFTWOOD C
ORIG	4033	WASHIN	26213	PRINTING PAPER,COATED OR UNCOATED,
ORIG	4033	WASHIN	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD

----------------------------------- ST=NY -----------------------------------

	SPLC	COUNTY	STCCS	PRODUCT
DEST	1654	ERIE	1195	POTATOES, OTHER THAN SWEET
DEST	1654	ERIE	20411	WHEAT FLOUR
DEST	1654	ERIE	20452	PREPARED FLOUR MIXES
DEST	1654	ERIE	20995	MIXED LOADS OF FOOD OR KINDRED PRODUC
DEST	1654	ERIE	24321	PLYWOOD OR VENEER OR BUILT-UP WOOD
DEST	1654	ERIE	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
ORIG	1654	ERIE	33123	IRON OR STEEL SHEET OR STRIP
ORIG	1654	ERIE	37149	MOTOR VEHICLE ACCESSORIES OR PARTS,NE

MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $1 MILLION OR MORE

---------------------------------- ST=OH ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
DEST	3418	CUYAHO	11212	PREPARED BITUMINOUS COAL
DEST	3418	CUYAHO	24321	PLYWOOD OR VENEER OR BUILT-UP WOOD
DEST	3418	CUYAHO	26213	PRINTING PAPER,COATED OR UNCOATED,
DEST	3418	CUYAHO	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST	3418	CUYAHO	26471	SANITARY TISSUES OR HEALTH PRODUCTS
DEST	3418	CUYAHO	41114	ARTICLES, USED
ORIG	3418	CUYAHO	33121	STEEL INGOT OR SEMI-FINISHED SHAPES
ORIG	3418	CUYAHO	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3418	CUYAHO	40241	PAPER WASTE OR SCRAP
DEST	3419	CUYAHO	20431	COOKED CEREALS,FLAKED,GRANULATED,POPP
DEST	3419	CUYAHO	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
DEST	3419	CUYAHO	26471	SANITARY TISSUES OR HEALTH PRODUCTS
DEST	3419	CUYAHO	41114	ARTICLES, USED
DEST	3461	HANCOC	20621	SUGAR,GRANULATED OR POWDERED,SUGAR CU
ORIG	3461	HANCOC	36311	HOUSEHOLD RANGES,OVENS OR SURFACE COO
DEST	3472	JEFFER	10111	IRON DIRECT-SHIPPING ORES, CRUDE
DEST	3472	JEFFER	11212	PREPARED BITUMINOUS COAL
DEST	3472	JEFFER	32741	LIME OR LIME PLASTER
DEST	3472	JEFFER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3472	JEFFER	33121	STEEL INGOT OR SEMI-FINISHED SHAPES
ORIG	3472	JEFFER	33123	IRON OR STEEL SHEET OR STRIP
ORIG	3472	JEFFER	33127	TIN MILL PRODUCTS
ORIG	3472	JEFFER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3422	LORAIN	29914	COKE PRODUCED FROM COAL
ORIG	3422	LORAIN	33124	IRON OR STEEL BARS,BAR SHAPES OR RODS
ORIG	3422	LORAIN	33126	IRON OR STEEL PIPE,TUBES OR FITTINGS
ORIG	3422	LORAIN	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3422	LORAIN	41114	ARTICLES, USED
DEST	3431	LUCAS	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
ORIG	3431	LUCAS	1139	GRAIN,NEC
ORIG	3431	LUCAS	20411	WHEAT FLOUR
ORIG	3431	LUCAS	20412	WHEAT BRAN, MIDDLINGS OR SHORTS
ORIG	3431	LUCAS	20419	FLOUR OR OTHER GRAIN MILL PRODUCTS,NE
ORIG	3431	LUCAS	20431	COOKED CEREALS,FLAKED,GRANULATED,POPP
ORIG	3431	LUCAS	28128	POTASSIUM COMPOUNDS
ORIG	3431	LUCAS	29914	COKE PRODUCED FROM COAL
ORIG	3431	LUCAS	49057	FLAMMABLE COMPRESSED GASES
DEST	3448	STARK	40211	IRON OR STEEL SCRAP,WASTES OR TAILING
ORIG	3448	STARK	33124	IRON OR STEEL BARS,BAR SHAPES OR RODS
ORIG	3458	WYANDO	32999	NONMETALLIC MINERALS OR EARTHS,GROUND

---------------------------------- ST=PA ----------------------------------

	SPLC	COUNTY	STCC5	PRODUCT
DEST	[illegible]	BUTLER	40211	IRON OR STEEL SCRAP,WASTES OR TAILING

MARKETS IN COUNTIES WITH REVENUE PROBLEMS OF $2 MILLION OR MORE

ST=SC

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	4470	CHARLE	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD

ST=TN

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	4273	MCMINN	26212	GROUND WOOD PAPER, UNCOATED

ST=TX

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	6847	HARRIS	28151	CYCLIC INTERMEDIATES FROM BENZENE,
ORIG	6847	HARRIS	28212	SYNTHETIC RUBBERS
ORIG	6847	HARRIS	49122	COMBUSTIBLE LIQUIDS, POLYMERIZABLE
DEST	6848	HARRIS	26212	GROUND WOOD PAPER, UNCOATED
DEST	6848	HARRIS	33126	IRON OR STEEL PIPE,TUBES OR FITTINGS
ORIG	6848	HARRIS	26213	PRINTING PAPER,COATED OR UNCOATED,

ST=VA

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	2624	HOPEWE	26311	FIBERBOARD, PAPERBOARD OR PULPBOARD
ORIG	2624	HOPEWE	28191	AMMONIA OR AMMONIUM COMPOUNDS

ST=WI

	SPLC	COUNTY	STCC5	PRODUCT
ORIG	3231	DOUGLA	20411	WHEAT FLOUR
ORIG	3231	DOUGLA	26613	WALLBOARD

SHARP AND ROBINSON
ATTORNEYS AT LAW
1129 20th STREET, N.W.
SUITE 204
WASHINGTON, D.C. 20036
—
(202) 466-8423

February 26, 1985

Mr. J. Paul McGrath
Assistant Attorney General
Antitrust Division
U.S. Department of Justice
Washington, D.C. 20530

Dear Mr. McGrath:

The Chicago South Shore and South Bend Railroad (South Shore), an independent midwestern railroad, is negotiating with the Norfolk Southern (NS) to acquire certain properties of the Consolidated Rail Corporation (Conrail) and the Norfolk and Western (N&W) located in the states of Indiana and Michigan. The negotiations are structured to meet the guidelines of your letter dated January 29, 1985, to the Honorable Elizabeth H. Dole, Secretary of Transportaton. The South Shore is writing to inquire whether your Department would consider the South Shore's acquisition of N&W and Conrail properties in St. Joseph and Clinton counties, Indiana, within the scope of your letter of January 29, 1985. These counties are included in the list of Markets In Counties with Revenue Problems of $2 Million or More attached to your letter of the 29th. While the South Shore could readily preserve and enhance rail competition in these counties, they are not listed for mandatory divestiture in the text of your letter. NS is therefore resisting South Shore's attempts to acquire freight operating rights in St. Joseph and Clinton counties.

The South Shores' proposed line acquisitions (and related trackage rights) are displayed in the map attached as Exhibit A. The focus of the proposed acquisitions is on the counties of St. Joseph, Allen, Clinton, and Marion, Indiana. Negotiations are also under way to obtain Conrail's operating easement between Porter, Indiana, and Kalamazoo, Michigan. The blue N&W lines South Shore proposes to purchase are secondary N&W lines that are logical candidates for abandonment if the Norfolk Southern obtains Conrail. The green lines reflect trackage rights that will extend the South Shore to certain secondary markets (particularly Lafayette and Logansport) or that will serve to provide efficient connections within the expanded South Shore system. None of the lines the South Shore is seeking would preclude the efficiencies Norfolk Southern might logically obtain from its proposed acquisition of Conrail.

Two of the Indiana counties involved, Marion and Allen, are on the mandatory divestiture list contained in your letter of January 29, 1985. The other two counties, St. Joseph and Clinton, are counties of concern since combined N&W/Conrail revenues are in excess of 2,000,000 dollars. Your letter of January 29 indicates that if the competitive issues raised by the proposed NS/Conrail merger were limited to counties similar to St. Joseph or Clinton, your Department would not normally oppose the proposed merger given (1) the efficiences that might be obtained, and (2) the relatively low volume of commerce in such counties.

The South Shore cannot determine from your letter whether the Department would encourage divestiture in markets other than those specifically listed in the text if divestiture were financially feasible. South Shore serves St. Joseph county directly and can easily serve Clinton county as part of the South Shore's proposed access to Marion county. Our initial review indicates that expansion to both markets is feasible and would preserve the same number of independent railroads now serving each county.

In particular, we would call you attention to the situation in St. Joseph county. As Exhibit A indicates, the N&W and Conrail have an extensive gathering network in that county. The combined NS/Conrail system would also retain a strong presence even after a divestiture since Conrail's main east-west line between Chicago and eastern points passes through the northern part of the county. South Shore's proposed acquisitions would preserve present and future rail competition to shippers in St. Joseph county. The South Shore would also improve its interchanges with Conrail and the Grand Trunk Western, which would further enhance competitive alternatives. St. Joseph is one of four Indiana counties with a population in excess of 200,000 people and its 1980 population of 241,617 was almost as great as that of Allen county (294,335), a county slated for mandatory divestiture. Moreover, according to the 1977 commercial census, St. Joseph possessed almost as many manufacturing enterprises (426) as Allen County (474). As an agressive independent railroad, the South Shore should be particularly effective in preserving shipper alternatives to and from points beyond the Chicago gateway. A reopened interchange with the Santa Fe at Logansport would provide similar opportunities for shippers in Allen, Marion, and Clinton counties and points in between.

The South Shore recognizes your Department has many matters to address concerning Norfolk Southern's proposed acquisition of Conrail. The South Shore, however, is well positioned to enhance competitive alternatives in St. Joseph and Clinton counties. We are therefore requesting your opinion whether South Shore's purchase of rail lines and trackage rights within those two counties is within the intent of your letter to Secretary Dole. We hope to have your response in the near future.

Truly yours,

John M. Robinson
Counsel for the Chicago South
Shore and South Bend Railroad

cc. Mr. John A. Darling
Mr. William Watt
Mr. Paul Mapes, Esq.

Attachment
Exhibit A Map

U.S. Department of Justice

EMS:JRW
60-384-037-11

John M. Robinson, Esq.
Sharp & Robinson
Attorneys at Law
1129 20th St., N.W.
Suite 204
Washington, D.C. 20036

Dear Mr. Robinson:

Thank you your for letter of February 26, 1985, concerning the efforts of the Chicago South Shore and South Bend Railroad to purchase track or obtain trackage rights on certain Conrail/Norfolk Southern properties in the States of Indiana and Michigan. As you noted in your letter, Chicago South Shore's objective is to provide competitive rail service to some of the counties where Norfolk Southern must divest properties in order to consummate its proposed acquisition of Conrail. Chicago South Shore is also proposing to serve two other counties where we identified potential competitive problems resulting from a merger between Conrail and Norfolk Southern, but where we have not required divestiture.

As you know, the Department has not taken a position either for or against any potential acquirer of the properties to be divested. We have left it up to potential purchasers of the properties to work out the terms with Norfolk Southern because it is our view that, in the first instance, only the buyer and the seller can know the suitability and value of the property under consideration. Thus, we are not now able to comment upon your proposal, particularly since, as I understand it, your discussions with Norfolk Southern are still quite preliminary. We have no inherent objection, however, to the proposal that you are advancing. While our letter to Secretary Dole requires only certain divestitures, we would not object to the provision of service to other counties so long as the provision of that service will not undermine the viability of such other new competitors as are created by the divestitures.

Once again, thank you for bringing the Chicago South Shore proposal to our attention.

Sincerely yours,

James R. Weiss
Assistant Chief
Transportation Section
Antitrust Division

Union Camp

1600 VALLEY ROAD, WAYNE, N.J. 07470 TELEPHONE (201) 628-2000

BEFORE THE

SENATE COMMERCE, SCIENCE

AND

TRANSPORTATION COMMITTEE

DISPOSITION OF CONRAIL

TO THE

PRIVATE SECTOR

My name is James P. Deehan. I am employed by Union Camp Corporation as its General Manager, Distribution & Transportation, at 1600 Valley Road, Wayne, New Jersey 07470.

Union Camp is a major manufacturer of paper products, lumber and chemicals with its heaviest production facilities - world class paper mills - located at Eastover, South Carolina; Franklin, Virginia; Montgomery, Alabama and Savannah, Georgia. Union Camp operates 68 plants in 28 states.

With 12 manufacturing production facilities located on Conrail and another 19 production facilities on the Norfolk Southern Railroad, Union Camp has a strong and direct interest in Congress's disposition of Conrail. This is particularly important since the Department of Transportation has recommended Conrail be sold to the Norfolk Southern Corporation. The location of major paper mill production in the southeast and with the important customer markets in the northeast, results in a substantial flow by rail of paper production from the south to customers served by both Norfolk Southern and Conrail. In order of magnitude, of the three railroads that receive the most freight revenue from Union Camp, Norfolk Southern and Conrail are two of those three railroads.

It's been Union Camp's preference to seek solutions to the Conrail problem through expanding rail competition in the northeast with acquisition of specific lines of Conrail, by its connecting railroads. Multiple rail ownership of all of Conrail's tracks would provide improved competition to the major markets in the northeast.

Another alternative is an independent Conrail, either through acquisition by a non-railroad operating company such as Alleghany, or through a public stock offering, provides shippers with the maintenance of the rail-to-rail competition in existence today.

There is minimum support for the multi-railroad disposition of Conrail. At the same time, an independent Conrail does not appear financially feasible as a successful alternative.

Such an analysis highlights the reality of the situation. A well-managed, financially sound railroad, such as Norfolk Southern, does have the capability to offer stability over the long term for the railroad situation in the northeast. There is, however, one major disadvantage: That is a merger between two of the three railroads serving all of the industry east of the Mississippi River. The sole remaining significant railroad is the CSX System.

Norfolk Southern's acquisition of Conrail without a requirement to maintain in place all rates, routes and gateways, would be such a dramatic reduction in competition that it would lead to major market distortions. For that most important reason, there must be assurances from Norfolk Southern Corporation agreeing to the maintenance of all competitive options, at origin and destination, which are now available to shippers using Conrail's services.

This shouldn't be an insurmountable problem. The synergism of Norfolk Southern's management and their operating skills, coupled with the greatly improved well run Conrail, no doubt, will result in significant operating efficiencies and cost savings. This is where the public should benefit, if this merger is approved. The merged (Norfolk Southern-Conrail) system would be in a position of attracting additional business to its single-line service by offering lower rates to apply via Norfolk Southern-Conrail. A shipper would then have the alternative, or option, of the new system's lower rates and, presumably, superior service; or, continue to use the joint rail routes and rates that are available today. At the same time, the railroads participating in the joint routes, of necessity, would feel the competitive pressure of the marketplace, to improve the cost of providing the joint railroad service in order for them to continue being competitive with the new single-line system.

It's important for members of Congress to be aware that competition in the railroad industry is unlike competition in all other businesses. No manufacturer is in a position to unilaterally require customers to use or purchase solely from any particular plant. Union Camp competes in the marketplace on the usual criteria: The quality of its product, customer service, price and a reputation for integrity and dependability. All of these attributes are evaluated by the customer in order for Union Camp to participate in that customer's business.

Railroads, on the other hand, are in a unique position of limiting options available to its customers. That is why in an issue so important to a major segment of the country, that a way be found to preserve and maintain railroad service for the long term, but in such a manner that will allow the free enterprise marketplace to function.

We greatly appreciate the Committee's consideration of this important subject. We thank you for providing us this opportunity to express Union Camp's views.

Respectfully submitted,

James P. Deehan, General Manager
Distribution & Transportation
Union Camp Corporation

The CHAIRMAN. We now stand adjourned.

[Whereupon, at 5:04 p.m., the committee adjourned to reconvene at 10 a.m., Tuesday, April 2, 1985.]

THE SALE OF CONRAIL

TUESDAY, APRIL 2, 1985

U.S. Senate,
Committee on the Judiciary,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Present: Senators Metzenbaum, Specter, DeConcini, McConnell, Biden, Denton, and Hatch.

Staff present: Kenneth Starling (Senator Thurmond); David Starr (Senator Metzenbaum); Debbie McIlroy (Senator Specter); Bill Sims (Senator DeConcini); Jan Walker (Senator McConnell); Renn Patch (Senator Hatch); Cynthia Lebow (Senator Biden), and Nick Chumbris (Senator Denton).

OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The Chairman. The committee will come to order.

Today, the committee is meeting to continue hearings on a subject of great importance to the Congress, the administration, and the public. Our hearings on the antitrust implications of the Department of Transportation's proposal to sell Conrail to the Norfolk Southern Corp.

Our first day of hearings was March 27. As I noted at that time, our purpose in conducting these hearings is to review the effect of the proposed merger on competition and to examine the Justice Department's analysis of those competitive effects.

At our first hearing, we heard witnesses from the Justice Department and from the major railroads affected by the merger. At that hearing, we learned that after Mr. McGrath performed his analysis, Mr. McGrath's new law firm was retained by Norfolk Southern for tax work related to the proposed merger. When Mr. McGrath confirmed this, he wrote to me that he was recusing himself from further involvement in the matter, even though he had had no contact with the firm in this matter.

I then referred Mr. McGrath's letter to Attorney General Meese. I suggested that Mr. Meese consider having the appropriate official at the Department of Justice reevaluate the antitrust implications of the proposed merger, in such a manner as he sees fit. I asked the Attorney General to advise me of his decision prior to this hearing.

This morning, I have received a letter from the Attorney General, which I will now read:

> Dear Mr. Chairman: Pursuant to your letter of 27 March, 1985, and our telephone conversation, I have reviewed the situation pertaining to the proposed sale of

Conrail to Norfolk Southern and the work of the Antitrust Division of the Department of Justice in relation to that proposed sale.

I have particularly taken into account the letter to you from J. Paul McGrath, Assistant Attorney General in charge of the Antitrust Division, dated 27 March 1985.

At my request, Associate Attorney General-Designate William Bradford Reynolds has examined the facts pertaining to the development of the conclusions and recommendations of the Antitrust Division concerning the above-described sale and the relationship between the law firm of Dewey, Ballantine, Bushby, Palmer & Wood, and Norfolk Southern, focusing particularly on Assistant Attorney General McGrath's knowledge of that relationship and any discussions concerning Norfolk Southern or Conrail that Mr. McGrath or others in the Antitrust Division may have had with partners or associates in the law firm directly prior to or since that relationship commenced.

Mr. Reynolds determined that the Antitrust Division, on behalf of the Department of Justice, had concluded and forwarded to Transportation Secretary Elizabeth Dole its 29 January 1985 report on the antitrust evaluation of the proposed Conrail sale well prior to the retention of the Dewey, Ballantine firm by Norfolk Southern, which occurred in the early part of March. Mr. McGrath did not know of such retention until the time of your Committee hearings last week. The attention of the law firm by Norfolk Southern was for tax advice and in no way related to the antitrust analysis. Further, Norfolk Southern has terminated its relationship with the law firm as of 20 March 1985. At no time was there any discussion whatsoever by Mr. McGrath or other members of the Antitrust Division with the Dewey, Ballantine law firm concerning any legal issues pertaining to the sale or any other matter pertaining to Norfolk Southern, except to verify the tax representation after the issue was raised at your Committee hearing. In the course of Mr. Reynolds 'examination, all of the facts set forth in Mr. McGrath's letter of 27 March 1985 have been verified.

In view of the fact that the retention of Dewey, Ballantine did not occur until well after the evaluation of the Antitrust Division had been completed, and since Mr. McGrath had not heard about such representation or discussed the Conrail/Norfolk Southern sale with anyone at Dewey, Ballantine, there has not been even as much as an appearance of a conflict of interest regarding this matter.

Thank you for bringing this matter to my attention and giving me the opportunity to review the situation and present these facts to you and the Committee on the Judiciary.

Sincerely,

EDWIN MEESE, *Attorney General.*

Now, this potential conflict of interest raised doubts in my mind about Mr. McGrath's analysis, and that is why I wrote to the Attorney General on March 27. With this potential conflict now resolved—by a finding that there was no conflict of interest, Mr. McGrath's analysis stands on its own merits.

I congratulate the Attorney General on his sensitivity to my concerns, and I thank him for his prompt and thorough response to my request.

We will now proceed with the hearing, and will hear from the distinguished Senator from Ohio.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator **METZENBAUM**. Mr. Chairman, as you welll know, I raised this issue concerning Mr. McGrath's relationship with the firm of Dewey, Ballantine, Mr. Salmon having registered as a lobbyist for them. And I particularly note that Mr. Meese does not use that word at all. But that is the fact, and you cannot sugarcoat it, and you cannot change it, because that is the word that is used in the law. Mr. Salmon registered on Dewey, Ballantine's behalf, as a lobbyist.

Now, to say that the concerns with respect to the propriety of Mr. McGrath's actions and the Attorney General's actions are all resolved because Mr. Reynolds has made what I would guess to be a cursory review, frankly, does not satisfy this Senator.

I think that we are looking at a situation where, at the inception, I raised the question concerning the price of this deal. I pointed out that it was set at a price of $1.2 billion, they were buying $800 million in cash, $250 million in surplus funds in the pension arrangement, and the opportunity to write off $3 billion notwithstanding the fact that the total cost was $1.2 billion.

So some questions would appear to be present as to why. I have now been informed since that time that the Department of Transportation agreement with Norfolk Southern actually goes much further than even Norfolk Southern proposed in their proposal that was made in their bid. And the agreement gives certain tax assurances, guarantees of the Federal Government, that Norfolk Southern itself did not even ask for. And either the Department was outnegotiated, or it intentionally gave away too much of the ball game and did not serve the public's interest sufficiently well.

In addition to that, there is another question that concerns the people of this country, and I, who feel that I speak for at least some portion of those people, and that is the whole question of how did they get to this price. Why is it $1.2 billion?

And I find that although Goldman, Sachs was hired before the bids were concluded, and that there was a statement put out before all the bids were in. The Journal of Commerce reported on May 31, 1984, that the company—and at that point, they were talking about Allegheny—originally offered $1.1 billion for Conrail, "an offer that has been deemed acceptable by Goldman, Sachs & Co., the company advising the Department of Transportation on the proposed sale."

When before has any adviser to any private company attempting to sell their property, or to the Government, in this instance, indicated publicly what the price ought to be, or the range of the price, before all the bids were in? Anybody would have been out of their cotton-picking' head if they had come in with a figure much more than $1.1 or $1.2 billion. Goldman, Sachs was saying that is about the right price to pay.

And so there is a whole aura of question that comes about in this matter. And then, we have the Antitrust Division coming here and saying to us, "Fine. Go ahead and make the deal." They do not even know what the deal is. They do not know what the divestiture aspects are. Senator Specter pointed that out the other day. They do not even know what the arrangements will be with respect to the sale.

And then, lo and behold, what a wonderful thing it is that they are selling and divesting themselves of some portion of this railroad, selling it to a company whose president came before us the other day and said they have an $80 million deficit, or a negative figure with respect to their current assets, current liability ratio. They have been losing money, and have not made money in 1 year. Another one comes forward and has no net worth, or almost no net worth.

So the whole question is, What is going on here; what kind of a deal is this? Is the Government just again getting the short end of the stick? Why are we running to sell this thing? Are we losing so much money? No—we made $500 million last year. And nobody says it is going to make much less than that this year.

And even the people from Norfolk Southern, I think I read somewhere that they said that, somewhere down the road, they might not be making any more than $200 million. That is not too shabby. We do not have too many places where we pick up $200 million a year.

So I would say, Mr. Chairman, that although Mr. Meese may have responded that he is satisfied, I am not saying there was any impropriety; I am not suggesting that Mr. McGrath was involved in anything that was improper, because I have no evidence to that effect, and, frankly, knowing Mr. McGrath, I would doubt it very much. But there is a perception that has to be avoided when the Government is selling a very valuable property. And when you put all the pieces together in this deal, and when you note also the determination that this bill will not be heard by the Finance Committee, and the determination that this bill will not be heard by the Judiciary Committee, except in this kind of a hearing, where we have no right to make a final determination one way or the other, I say, Mr. Chairman, that this deal, every day, in every way, starts to look worse and worse to the Senator from Ohio.

The CHAIRMAN. The distinguished Senator from Pennsylvania.

OPENING STATEMENT OF SENATOR ARLEN SPECTER

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Chairman, there have been three major developments which have occurred recently, which I believe require further study by this committee. I do commend the chairman for convening the hearing last week, and for convening this hearing today.

The first issue which I believe requires more analysis is the question raised by the distinguished chairman of this committee in his letter of March 27 to the Attorney General, concerning the perception of impropriety, when Senator Thurmond wrote to Attorney General Meese, saying, "In order to remove any perception of impropriety, I suggest you have the appropriate official of the Department of Justice reevaluate the antitrust implications of the proposed sale of Conrail to Norfolk Southern." The issue of reevaluation, Mr. Chairman, has not been accomplished by what Attorney General Meese has written. Attorney General Meese has simply recited facts which were pretty much known to this committee when we met last week—in terms of the sequence of events, when Mr. McGrath was hired, the fact that the other man was giving tax advice, and the fact that there had not been any conversations.

But I would think it appropriate, Mr. Chairman, that more analysis be given by the Department of Justice to your suggestion about the perception of impropriety. Absent that further consideration, which we apparently do not have, then it is my thought that this committee ought to go into that question itself in our oversight function over the Department of Justice to answer the question which you, Mr. Chairman, raised as to the perception of impropriety.

The second issue which I think requires substantially more analysis before this committee is in a position to render a judgment or an opinion on this acquisition involves the question of divestiture. There has been a recent development with Senator Glenn of Ohio, writing to Senator Danforth, asking that there not be a markup in the Commerce Committee until the facts of divestiture are decided. Senator Glenn states that it is asking too much for the Congress of the United States to treat this major matter by leaving it up to the Justice Department to make some determination in the future as to whether acquisition by Guilford and Pittsburgh and Lake Erie are sufficient to provide the kind of competition mandated by the Department of Justice letter itself. These facts were explored in the hearing last week about Pittsburgh and Lake Erie's deficit situation, and the lack of stability or real capitalization of Guilford. On that subject, Mr. Chairman, at the executive committee meeting on Thursday, I intend to offer a resolution for consideration by our committee. This resolution will urge that the Senate take no action, and that no committee of the Senate take action until there is a detailed recitation of what the divestiture is to be, and a thorough analysis of the financial stability of the proposed acquiring companies, so that we can make the determination in the Senate and in the Congress as to whether the requisite competition would be present.

Mr. Chairman, there is a third fact which has just come to light and is present in the morning media. I quote now an article in the Philadelphia Inquirer of this morning, which discloses a study made by the U.S. Railway Association, which I have requested, but have not yet seen. The U.S. Railway Association forecasts that Conrail will have a net income of $428 million this year, $200 million in 1986, $202 million in 1987, and $459 million in 1988. There disclosures certainly materially undercut the basic premise of the Secretary of Transportation that a Norfolk acquisition is necessary to provide a deep pocket and to provide stability for Conrail. We now have new facts which further the contentions which some of us have raised that this proposed sale is a steal, purely and simply. This company presently has more than $1 billion in cash. Considering the fact that the taxpayers have put $7 billion into Conrail, that it has a book value in the range of $4 billion, that it has depreciable assets in the range of $3.1 billion, which would give Norfolk a tax deduction of $1.4 billion, a purchase price of $1.2 billion for 85 percent of the stock is absurd.

So it seems to me, Mr. Chairman, that the plot is thickening on a number of material issues—two of which are very important for consideration by this committee. One, is the issue of divestiture, so that we can make a responsible determination, to compliance with the antitrust laws. Beyond that, we really must have answers to the questions which you, Mr. Chairman, posed on the perception of impropriety, which I believe have not been answered as of this moment and which, in my judgment, require an explanation to this committee.

Thank you, Mr. Chairman.

The CHAIRMAN. The distinguished Senator from Arizona.

OPENING STATEMENT OF SENATOR DENNIS DeCONCINI

Senator DECONCINI. Mr. Chairman, thank you very much. I know the committee has heard from a number of distinguished witnesses, both supporters and critics of the proposed sale of Conrail to Norfolk Southern. Let me say at the outset, Mr. Chairman, that I do not believe the Government should be in the business of running a railroad. I generally support the idea of the Government divesting itself of Conrail.

The question for me is whether the Department of Transportation proposal is the best alternative for returning Conrail to the public sector. Criticism of the sale has centered on two grounds: economic and antitrust. The economic concern questions whether the Department of Transportation negotiated the best price for the sale of the American taxpayers' Conrail assets. I have grave questions, as other members have pointed out, whether this is the best sale price, given Conrail's assets and cash-flow. This is a question of major importance to this Senator.

However, it is the antitrust ramifications of this transaction which I feel are also of paramount importance to this committee. We must bring to bear our experience in the field of antitrust. Issues such as the impact on competitive shippers, the proposed blanket immunity from the antitrust laws that would be extended to the Conrail/Norfolk-Southern sale, and the degree to which thè antitrust laws generally should apply to the railroad industry, are all before us today.

I am pleased that the chairman has seen fit to conduct such thorough hearings into this sale and the effects of the law.

I only wish, Mr. Chairman, that we had a greater handle on this subject matter before we are asked to move forward on it. As I indicated in my opening paragraph, I believe we should sell Conrail, but the actual mechanics and to whom concern me. The case has not been made at this juncture, at least to satisfy this Senator.

Thank you, Mr. Chairman.

[The prepared statement of Senator Simon follows:

PREPARED STATEMENT OF SENATOR PAUL SIMON

MR. CHAIRMAN, the sale agreement the committee will be examining in these hearings encompasses several states, hundreds of counties, scores of shippers and the livelihoods of thousands of railroad workers. I look forward to these proceedings as an opportunity to clarify the issues that have been raised in the volumes of evidence that already have been produced on the several sides of this question.

I hope that I will find it possible to wholeheartedly endorse this sale and the enabling legislation proposed to us by the Administration. But many questions must be answered before this Senator can say that this is the proper vehicle to achieve what most of us agree is a worthy public policy goal -- to return Conrail to the private sector.

No one will dispute the fact that this sale proposal creates new problems even as it attempts to solve several old ones. The Department of Justice itself has noted that it would have to oppose this sale were it not for the divestiture plan it has developed to accompany the sale document. This fact alone does not condemn this proposed sale, but it does mean that extra care must be taken to evaluate the remedies proposed by the Department of Justice for their adequacy.

The State of Illinois has long been a rail gateway state. We are the interchange point between several of the great railroads of the East with several of the great railroads of the West. We are also proud to be the home of several of these railroads. Some of the questions our state has about this proposed sale arise from the concern that it would diminish traffic through these long-established gateway points, and diminish it only for the convenience of a combined Norfolk

Southern and Conrail.

Other questions arise from the changed competitive climate this sale would create. I have heard from many shippers in our state on both sides of a sale to Norfolk Southern, and in many respects their strong feelings pro or con stem from the excellent service they now obtain from either Norfolk Southern or Conrail. This is testament to the fact that both of these railroads are extremely well-managed, and that each railroad has been aggressive and solicitous in serving shippers' needs. However, it must also be said that four Illinois counties that now have fully competitive rail service would suddenly become dominated by only one railroad under this sale. There certainly are other states where the impact would be more pronounced, but it is a concern to our state as well.

So, Mr. Chairman, I welcome these hearings. This Senator has not yet decided the merits of this proposal, and I look forward to this opportunity with the expectation that these hearings will clarify these issues and the stakes that our nation's commerce, the State of Illinois and the federal taxpayers have in our decision.

# # # # # # # #

The CHAIRMAN. Thank you, Senator.

Because of the length of our first hearing, we were unable to hear the witnesses from the Departments of Transportation and Treasury, so we have asked them to return today.

In addition to the administration witnesses, we will hear from a number of companies which ship goods on railroads. We have invited these business people to join us today to help us understand the forces of competition in the markets affected by the Norfolk Southern purchase of Conrail. We have also invited witnesses from some of the ports which receive or send large volumes of goods by rail.

Our witnesses represent a cross-section from various industries, from large and small businesses, on all sides of the issues. These witnesses will share with us the perspective of the customers of rail service. They will describe railroad competition for their patronage in a number of markets. If they wish, they may offer us their views on the effects of the proposed merger. But these witnesses are not involved in the merger, except as customers of some of the railroads from which we heard on the first day.

Other shippers who could not be here today have submitted statements on all sides of the issues, and those statements will be included in the record.

I welcome all of our witnesses. I thank them for taking time from their business schedules to share their views with us, and I look forward to their testimony.

We are going to have to stop today at 12:30, and we will come back at 2.

We are going to adhere strictly today to the 5-minute rule. The red light means your time is up. We will put your entire statement in the record, but when this red light comes on, we want you to stop. We have to do it in order to hear all these witnesses, and if we indulge you, as we did in the last hearing, it will go on and on, and some witnesses will not get to be heard, and we have a lot of witnesses to hear today.

Senator DECONCINI. Mr. Chairman, does that apply to questions? Maybe it ought to.

The CHAIRMAN. We were allowing 10 minutes to each on questions, and when that time is up, we are going to ask you to stop, too. We indulged you before, and some went 15, 20 minutes. We are not going to do that today, because it is not fair to all these witnesses who have come here, who will not be heard unless we adhere to the schedule.

Senator METZENBAUM. Well, I am sure the Chair does not mean to indicate that we would only have one round.

The CHAIRMAN. I do not mean to indicate that, but there is no use to rehash. In other words, if one member of the committee has asked a question, there is no use to elicit again the same question, if you could ask other questions. All we want to do is bring out the facts. We are not trying the case, and we just want to elicit the facts. I would hope we will not have duplication, as we did in the first hearing. We had tremendous duplication.

Our first witness today is the Honorable James C. Rooney, deputy administrator, Federal Railroad Administration, U.S. Department of Transportation.

Mr. Rooney, we are glad to have you with us, and you may proceed for 5 minutes.

STATEMENT OF HON. JAMES C. ROONEY, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, U.S. DEPARTMENT OF TRANSPORTATION, WASHINGTON, DC, ACCOMPANIED BY MARK LINDSAY, DEPUTY CHIEF COUNSEL, FEDERAL RAILROAD ADMINISTRATION

Mr. ROONEY. Mr. Chairman, thank you for the invitation this morning.

I would like to ask that my statement be placed in the record, and also for one more favor, with your leave and the leave of the members, and that is that I might have Mark Lindsay, Deputy Chief Counsel of FRA, sit with me up here, just in case.

The CHAIRMAN. We will put your entire statement in the record, and you have 5 minutes.

Mr. ROONEY. Mr. Chairman, the incisive questioning of you and your fellow members of this panel reminds me of a story about a Christian and a lion. But, since you have instituted the 5-minute rule here this morning, I am going to race by that. I will tell it at the end, if we have time.

The CHAIRMAN. You had better just put that story in the record, since you just have 5 minutes. [Laughter.]

Mr. ROONEY. Let me try to contribute to the proceeding this morning, Mr. Chairman, by stepping back in time, offering a narrative of the events that led us to where we are today in this proposition.

As you know, a critical juncture was reached in 1981 when the Congress passed the Northeast Rail Services Act. Congress had determined that two courses of action were available to it: Either to sell Conrail as an entity, a going enterprise, by divesting the stock that the Government held, or a demonstrably more Draconian measure—namely, to auction off Conrail's lines and equipment piecemeal, for the highest liquidating value in a transfer of service, which this report here, "Recommendations on Northeast Rail Service of 1981" suggested might cost something on the order of 20,000 jobs and 8,000 out of 16,000 miles of the then existing trackage.

Congress determined that a time of testing be allotted, at the end of which the U.S. Railway Association was to make a determination of Conrail's prospects for long-term profitability.

Against the backdrop of regulatory freedoms granted by the Staggers Rail Act of 1980, which Conrail was utilizing vigorously, Congress took additional measures to unburden Conrail of the heavy mantle of costs that it was carrying. For example, commuter operations would be shed and placed in State and municipal hands; labor contracts would be renegotiated and all employees would work for less wages; the act made it easier for Conrail to shed excess employees and tracks, and Conrail was exempted from State taxes.

These ministrations and good management proved effective. On June 1, 1983, the USRA found in a positive although heavily caveated report, that Conrail would be profitable. And, given that Conrail were profitable, NERSA then required the sale of Conrail as an entity through the sale of the Government's 85-percent interest in its common stock.

These mandates and the prioritization of objectives, namely, to ensure continued rail service, promote competitive bidding, and maximize the return of the taxpayer, did in fact dictate the framework for all of our subsequent undertakings.

Interest in purchasing Conrail developed slowly as Conrail shrugged off the effects of the recession. Its 1983 financial results became known, and 1984 looked likely to exceed them by a wide margin. We and our investment adviser, Goldman, Sachs, visited with and interviewed more than 100 companies, individuals, and partnerships who had the resources to buy the company, and we spoke to all of the railroads who could logically be presumed to be interested in Conrail, and canvassed their interests as well.

As 1984 progressed, it became apparent that some interest was being sparked. By spring of 1984, we had more than half a dozen serious lookers. The first of these bids, as you know, to become public was the Alleghany Corp. bid on April 10, 1984.

We consulted with Goldman, Sachs, and they advised us that Alleghany's bid, for some $1 billion, initially, fell within the range—passed over the threshold of—reasonable compensation and that we could use that bid to call other competing bidders to the table. That is exactly what we did by setting a deadline. We were pleased and surprised to receive more than 15 serious bids for the corporation. Those could be portrayed as a range, from bids which were both well backed and very responsible to bids which were of a more leveraged nature, the leverage buyouts which have been in vogue, but to which we were predictably cool. It was then a matter of choosing that one best bid.

As the field narrowed from six bidders and then to three, we scrutinized each aspect of each bid. Financial capacity was examined by Goldman, Sachs, and we were working to tighten up and expand the covenants that we would place on the buyer to assure high levels of plant investment, maximum service, and to prevent the dissipation of the company's cash resources.

The CHAIRMAN. Your time is up.

[The following was received for the record:]

TESTIMONY OF JAMES C. ROONEY
DEPUTY ADMINISTRATOR
FEDERAL RAILROAD ADMINISTRATION
BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
MARCH 27, 1985

Let me contribute to this proceeding by stepping back in time. I offer a narrative of the events which led to the bidding process in 1984 and to where we are today.

A critical juncture in Conrail's future was reached in 1981 when the Northeast Rail Service Act or NERSA was enacted by the Congress. After years of lackluster performance and mounting losses, in 1981 Conrail had taken its first halting step toward profitability, although only in an accounting sense, rather than a use sense since its profits were derived from the sale of assets under the so-called "safe harbor leases".

Congress determined that two courses of action were available--either to sell all of Conrail as an entity--a going enterprise--by divesting of the Government's stock interest or a demonstrably more draconian measure--to auction off its lines and equipment piecemeal in a transfer of service. A time of testing was allotted, at the end of which the United States Railway Association was to make a determination of Conrail's prospects for long term profitability.

Against the backdrop of the regulatory freedoms granted by the Staggers Rail Act of 1980, which Conrail was utilizing to concentrate its traffic and shed unprofitable business, Congress took additional measures to unburden Conrail of the heavy mantle of costs it was carrying. For example NERSA provided that:

- o Commuter operations would be shed and placed in state and municipal hands.

- o Labor contracts could be renegotiated and all employees would work at reduced wages.

- o The Act made it easier for Conrail to shed excess employees and tracks, and

- o Conrail was exempted from state taxes until sold.

These ministrations and good management proved effective. On June 1, 1983, the USRA found in a positive, although heavily caveated report, that Conrail would be profitable. Given that Conrail was profitable, NERSA then required the sale of Conrail as an entity through the sale of the Governments 85 percent interest in its common stock and required that the Secretary develop and submit a plan that in the language of the Act:

- o ensures continued rail service;
- o promotes competitive bidding for Conrail's stock; and
- o maximizes the return to the taxpayer for the investment that has been made... .

These mandates and the prioritization of objectives which they dictate formed the framework for all of our subsequent undertakings.

Interest in purchasing Conrail developed slowly as Conrail shrugged off the effects of the recession. Its 1983 financial results became known and 1984 looked likely to exceed them by a wide margin. We and our investment advisor-- Goldman, Sachs and Company--held discussions with all the major railroads and over 100 large firms, partnerships, and individuals who would have the resources to buy Conrail. As we now look back in time, we must remember that in 1983 a bidder's looking at Conrail in private hands did not see $313 million in 1983 profits, but rather something nearer $90 million with room for improvement in 1984.

1984 progressed, it became apparent that some interest in acquiring Conrail was being sparked. By spring of 1984, we had more than a half-dozen serious lookers. the first of these bids to become public was the initial bid received from Alleghany Corporation on April 10, 1984.

We consulted with Goldman, Sachs and they advised us that Alleghany's bid--for some $1 billion initially--fell within the range of reasonable compensation. This bid could then be used to call other bidders to the table, and we effectuated the competitive bidding process by setting a deadline.

We were both pleased and surprised to receive a total of 15 bids on June 18th -- the deadline for bidding. As with any sampling of bidders, the bids ranged from very responsible, well-backed ones to the leveraged buyouts which have been in vogue, but to which we were predictably very cool.

It was then a matter of choosing the one best bid: To borrow a leaf from Secretary Dole's recent testimony to the Senate Committee on Commerce Science and Technology--to choose and recommend to you that sale plan that assured long term rail service to the region, true employment stability for Conrail's work force, and a very high level of confidence that Conrail will never again become a ward of the Federal Government.

As the field narrowed to six bidders and then to three, we scrutinized each aspect of each bid. Financial capacity was examined by Goldman, Sachs. We were working to tighten and expand the covenants we would place on the buyer to assure high levels of plant investment, maximum service, and to prevent dissipation of cash resources. We consulted continuously with Treasury to ensure that what we and the bidders were contemplating was consistent with Treasury's views and the mission of the Internal Revenue Service to administer and enforce the federal income tax laws.

Finally, and very much to the point of today's proceeding, as it become apparent that Norfolk Southern might be a "finalist" we studied the competitive implications of that choice--were it to be made.

Our internal studies in most cases preceded the referral to the Justice Deparment. They proceeded along three main courses of inquiry.

- o We were interested in knowing the geographic scope of potential problems: that is, where competition was reduced by the loss of one of two or more competing carriers.

- o We looked at the gateways at which NS lines met Conrail lines and where other carriers were competing.

- o We also examined the generalized hypothesis of bigness per se as a bar to NS' continued candidacy.

Norfolk Southern's current operations, viewed now in terms of traffic tonnages not miles of track, are heaviest along a trunk which is oriented north-south in Ohio along a line running from Portsmouth and Cincinnati northward to Columbus and Lake Erie. The branches emanating from this trunk are healthier toward the southwest, but the effects of the final system plan railroad restructuring and regional traffic shifts have taken their toll on the branches facing eastward. By virtue of these changes, a number of NS lines which had served its predecessors well in an era when they handled interterritorial traffic were now handling much less traffic. In the Buffalo-Cleveland corridor, for example, NS' market share had fallen to 10 percent of the traffic moving there.

The benefits and detriments of a merger of NS and Conrail can be argued from either the generalized perspective (i.e., bigness *per se*) or from the particular, (i.e., the effect on specific markets, traffic lanes, and ultimately shippers.

While NS+CR would be larger in physical terms:

Physical Measures	NS+CR	CSX
Miles of Track	66,881	44,697
Locomotive Owned/Leased	6,159	4,093
Cars Owned/Leased	259,560	213,085
Employees	77,550	56,092

Norfolk Southern-Conrail and CSX would be more nearly in balance with respect to indicia of activity such as the tons of traffic each would handle, the carloads they would carry, and the revenue ton miles (the product of the weight of lading in tons and the distance the lading is transported in miles) each system would generate.

	NS-CR	CSX
Tons (millions)	426	412
Carloads (millions)	6.6	6.0
Revenue Ton Miles (Billions)	154	124

We examined those locations--or stations--which absent divestitures would no longer receive multiple carrier service, and we found 34 points. These points and markets were a virtual overlay for those later found within the divestiture region by the Department of Justice.

Based on our preliminary analysis, we determined that, absent any divestitures, the problems associated with Norfolk Southern's acquisition of the Conrail lines and the attendant loss of multi-carrier service were limited in scope to fewer than one percent of the cars moving in the region.

We became increasingly convinced that Norfolk Southern's competitive presence north of the Ohio River did not loom as large as we had initially thought. Neither did the issue of bigness per se lead to the creation of an overwhelming juggernaut in the east and, in fact, CSX would remain relatively stronger than the combined NS-Conrail in the faster growing Southeast. Most importantly it began to appear to us that, at least within the region, competitive problems were being isolated in clusters which might be remedied by an organized, interconnected system of lines rather than finding that problems were so dispersed that no logical set of lines could remedy them.

In early September 1984, we transmitted the matter of Norfolk Southern's acquisition of Conrail to the Department of Justice, to be subjected to their independent scrutiny, while we continued to negotiate with all three remaining bidders to bring their proposals into conformity with the conditions we and the Department of Treasury were placing on matters other than those relating to competition.

Five months later, at the end of January 1985, the Department of Justice released its analysis of the competitive implications of the proposed sale and produced with it a set of asset divestitures which had to be accomplished in order to remedy the perceived competitive harms and remove its opposition. Norfolk Southern has agreed to be bound by the Department of Justice's strictures and has, as you know, reached agreements in principle with Guilford and Pittsburgh and Lake Erie to convey those lines necessary to cure the competitive problems which Justice found.

As I stated earlier, we have been guided throughout this process by the enacted statutes. Nevertheless, some questions have been posed and concerns raised about our referral of this matter to the Justice Department and about other provisions of the Memorandum of Intent and the proposed legislation.

- The Congress, not the Department of Transportation, spoke clearly and directly to the issue of administrative and judicial review. Section 408(c) of NERSA states unambiguously that no transfer of stock etc., shall be subject to judicial review or to review by the Commission.

- Our referral to Justice and the language presented in the Senate bill are consistent with that directive.

  - The Antitrust Division has a well staffed, and independent Transportation Division which routinely participates in ICC cases and scrutinizes mergers of unregulated transportation companies. Our conviction about their impartiality led us to refer the matter to them for resolution. The very wording of their report gives lie to the claim that they proposed to act as mere counselors. A mere counselor does not begin his report to the client with a statement of flat opposition unless his conditions are followed to his complete satisfaction.

  - The proposed Senate bill language comports with Congressional intent as expressed in NERSA in that it contemplates affirmative, implementing legislation--leaving the matter of acceptance of the Secretary's recommendation entirely within the volition of Congress.

- Once the Congress completes its deliberations and enacts a law, only the sale, the Justice Department divestitures, and the coordination of railroad operations would be immune from review.

- These provisions are directly analogous to a railroad merger when conditions are imposed on the merger by the Commission, and are consistent with Section 408(c) of NERSA. This effectively adapts the immunity granted in NERSA to the facts of this sale.

o Finally, there is the allegation that the proposed transaction would seriously undermine the pro-competitive Staggers Act reforms of 1980 by causing Conrail/NS to maintain or re-establish joint rates with small Eastern Railroads and that re-regulation may also result from Justice's prescription that the merged company provide access to other rail carriers so the latter may serve shippers located in markets they do not now reach.

For Consolidated Rail Corporation to come before this and propose that the pro-competitive provisions we and Department of Justice inserted contravene the Staggers Act and invade shipper prerogatives is a serious misconstruction of our intentions and of current events. Mr. Chairman, the facts are these:

- The Association of American Railroads, acting for and on behalf of the Nation's railroads, has just reached accords with a number of shipper's organizations to produce exactly the same results intended by the insertions here. Those accords have been submitted to the ICC to obtain its blessing and the immunity that would confer.

- The Commission itself had already concluded it would no longer permit wholesale rate cancellations and gateway closings to occur without intense scrutiny.

- Finally, Mr. Chairman, you are about to hear from a group of shippers who will speak for and against this sale proposal. I would speculate that none among them would tell you it would damage their interests to have regional carriers afforded the opportunity jointly to participate in their traffic or to have an additional carrier access their origin and destination shipping points.

Mr. Chairman, that completes my testimony. I would be happy to attempt to answer any questions the Committee may have.

The CHAIRMAN. Mr. Rooney, in your view, did the antitrust review of the Norfolk Southern/Conrail merger differ in any way from the review recently performed by the Justice Department in other rail mergers?

Mr. ROONEY. Did our review, Mr. Chairman, or did the Justice Department's review?

The CHAIRMAN. I will repeat the question. In your view, did the antitrust review of the Norfolk Southern/Conrail merger differ in any way from the review recently performed by the Justice Department in other rail mergers?

Mr. ROONEY. Senator, the Justice Department, I believe, used an origin-and-destination point analysis, which is intended to get at the subject of movements to and from sources and markets within the territory served by the two carriers so as to present as global a view of the competitive implications as possible. That is a technique they have used in the past, and it is a customary technique to use in looking at these propositions.

The CHAIRMAN. Please speak up. The people here cannot hear you, the audience and the press and the other people.

Mr. ROONEY. I said that is a customary procedure to be used in these kinds of mergers.

The CHAIRMAN. So your answer is——

Mr. ROONEY. The type of technique they used, namely, the origin-and-destination point analysis, with the implications for goods moving from sources to markets within and without the region, is a typical form of analysis to perform in this kind of proceeding.

The CHAIRMAN. I construe from your answer—and correct me if I am wrong—that this antitrust review here, then, did not differ in any way from the review recently performed by the Justice Department in other rail mergers; is that correct or not?

Mr. ROONEY. The Justice Department can use another type of review which is called a point-pair or origin-to-destination review. It is more typical to use that in a situation which is oriented toward a parallel merger, as opposed to having aspects of considerable, end-to-end relevance, as the NS/Conrail merger might.

The CHAIRMAN. Did the Justice Department review differ in any way from the review of rail mergers normally done by the Interstate Commerce Commission?

Mr. ROONEY. The Interstate Commerce Commission typically uses, Mr. Chairman, a number of these methodologies, but it really will tend to accept and sift through and judge the applicability of analyses done by the other parties to the proceeding.

The CHAIRMAN. What role, if any, will the Transportation Department play in identifying the rail lines that must be divested under the Justice Department's plan?

Mr. ROONEY. Senator, we have been asked to simply be a party to the negotiations which led to the proposals, the so-called agreements in principle, to note that the goings on were indeed carried out in the spirit of business bargaining. But, the Justice Department has asked us to play no substantive role in that process. They will make the final determinations and the analyses themselves, using their own consultants, I presume.

The CHAIRMAN. The distinguished Senator from Ohio.

Senator METZENBAUM. Mr. Chairman, I want to put into the record at this point, in view of your question, which I think was a very profound one—and that is, are there any differences—the State of Ohio prepared a chart indicating the differences between the way this matter is being handled and the normal procedure for a railroad merger. And you not only have the antitrust variation, but you have the variation with respect to the ICC procedures, the failure in this instance to let States have an opportunity to testify and cross-examine and prepare comments and testimony. You do not have, in this matter, the labor impact analysis, and many of the others.

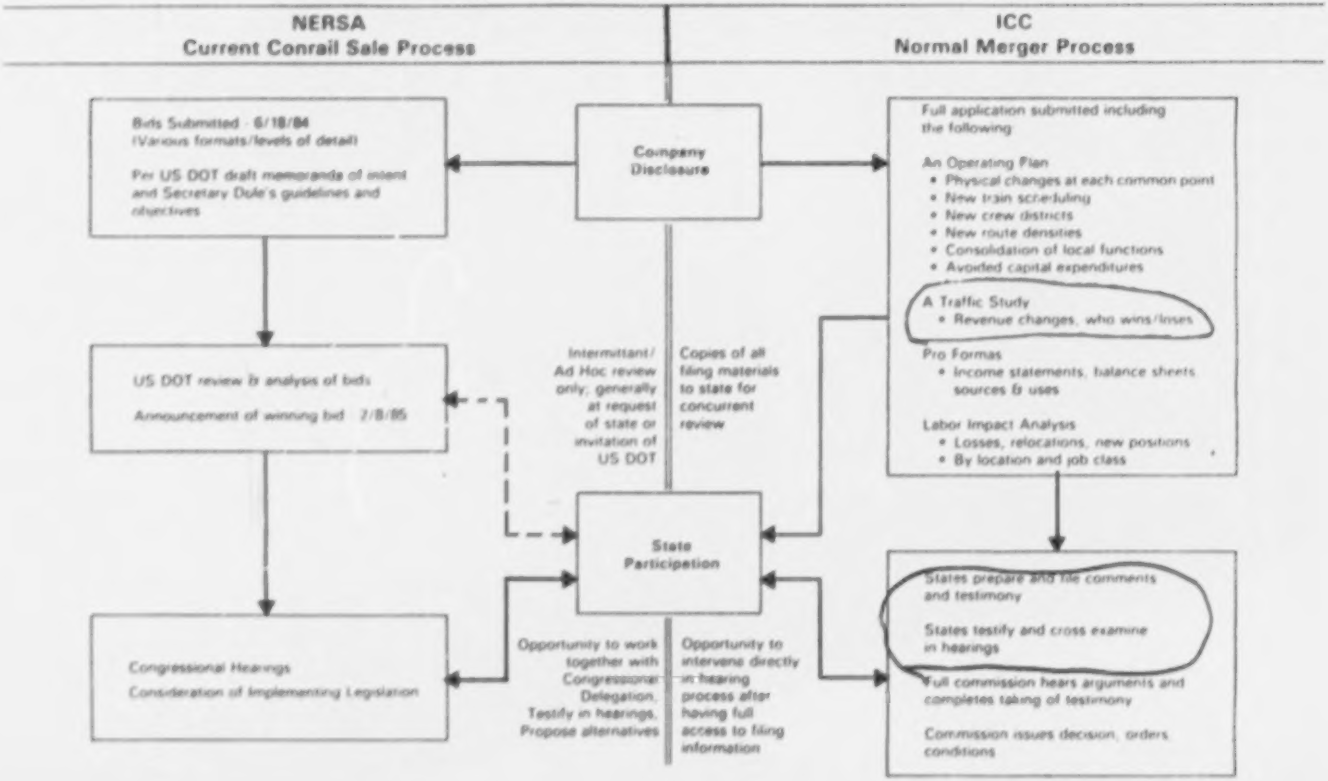
Rather than take up the time of this witness or of the committee, I ask unanimous consent that this diagram be included in the record.

The CHAIRMAN. Without objection, so ordered.

[The following was received for the record:]

FROM STATE OF OHIO

Company Disclosure/State Participation for Railroad Merger Proceedings under NERSA (Current Conrail Process) versus ICC (Normal Merger Process)


NERSA
Current Conrail Sale Process
ICC
Normal Merger Process
Bids Submitted - 6/18/84
(Various formats/levels of detail)
Per US DOT draft memoranda of intent and Secretary Dole's guidelines and objectives
Company Disclosure
Full application submitted including the following
An Operating Plan
• Physical changes at each common point
• New train scheduling
• New crew districts
• New route densities
• Consolidation of local functions
• Avoided capital expenditures
A Traffic Study
• Revenue changes, who wins/loses
Pro Formas
• Income statements, balance sheets sources & uses
Labor Impact Analysis
• Losses, relocations, new positions
• By location and job class
US DOT review & analysis of bids
Announcement of winning bid - 2/8/85
Intermittant/ Ad Hoc review only; generally at request of state or invitation of US DOT
Copies of all filing materials to state for concurrent review
State Participation
States prepare and file comments and testimony
States testify and cross examine in hearings
Full commission hears arguments and completes taking of testimony
Commission issues decision, orders conditions
Congressional Hearings
Consideration of Implementing Legislation
Opportunity to work together with Congressional Delegation, Testify in hearings, Propose alternatives
Opportunity to intervene directly in hearing process after having full access to filing information

Senator **Metzenbaum**. Now, Mr. Rooney, did your Department prepare any specifications with respect to taking of bids? Did you put out any specs?

Mr. **Rooney**. No, Senator, I do not believe we put out any specs. I do know that in speaking to these various parties, Goldman, Sachs in particular used an offering circular, which illustrated the historical, geographic, traffic, and business facts concerning the company.

Senator **Metzenbaum**. But it did not say anything about the terms and conditions of a sale; is that right? It just sort of said, "This is what we have to sell. We would like your offer."

Mr. **Rooney**. Well, let me say this, Senator. Concurrently, with that process of raising interest, we had in preparation a document which later took the form of a memorandum of intent which, from the very early onset of any discussions with people, became the format for discussions.

Senator **Metzenbaum**. Well, I will come back to that in a minute.

Why didn't you use sealed bids?

Mr. **Rooney**. Senator, it is difficult to comprehend the operation of a sealed bid, or Dutch auction, in this particular instance. There are just too many complications, not the least of which is the notion that we wanted to have a very significant number of protections, such as public interest covenants, built into this proposition. This would not be a simple money-for-property-type transaction in the way that one might sell a surplus post office or something like that.

Senator **Metzenbaum**. Let me ask you this. Do you think when you are trying to sell something that it is good judgment to go public and say what the figure is that somebody has offered and then, at the same time, say that the advisor has indicated that it is within the range of reasonable compensation—and I think you went on to say it might serve as a floor in the bidding. Now, when you said that, you pretty much set the level. You kept anybody from coming in at $2.5 billion, or $2 billion, or whatever the figure was. Everybody knew that the ballgame was somewhere in the $1 billion range. And you went public, and Goldman, Sachs went public.

Now, I came out of the business world, and I have never heard of this kind of procedure, where you say, "Well, we have this offer for our building, of $450,000, and that is sort of within the range of what we are talking about, and if somebody wants to come in with more"—unless you are going to conduct an auction.

But it certainly means, if you say $450,000, you do not expect to get $1 million. Here, you had a project, an operating company, that nobody was quite sure what it was worth. And I have difficulty as a businessperson in understanding going public with a statement of (a) what the offer was, which I question the propriety of doing, but apparently, Alleghany did not object; and (b) having the advisor say that it is within the range of reasonable compensation. I would like to get some explanation as to why you did it. Why didn't you hold your tongue?

Mr. **Rooney**. Senator, you make the argument that the $1 billion implied a ceiling of some kind.

Senator METZENBAUM. No, just——

Mr. ROONEY. I would make just the opposite argument that the $1 billion, if anything, implied a floor, and that the words "within the range of" are certainly suitably vague that they do not declare price.

Senator METZENBAUM. Well, wouldn't you say that within the range of reasonable compensation indicates that if somebody such as the XYZ Co. was looking at it, and if they went to their board and said we ought to put up an offer of $2 billion, that the members of that board or the stockholders would have thought they had gone loony and lost their marbles, because—what the devil did you come in with a $2 billion offer for—they have already told you they are only expecting to get around $1 billion, or somewhere within the reasonable range of that amount.

Mr. ROONEY. Senator, we are both speculating about some words that it occurs to me, we may well check before we do——.

Senator METZENBAUM. I am quoting from the Newark, NJ Star Ledger of August 11, 1984. And the quote that I have here—and they are quoting you: "Christopher Rooney said Friday his company received two offers for Conrail, expects several more by the June 18 deadline. The latest offer was made in early April by Alleghany Corp." It goes on to talk about Alleghany, and then it says: "The Federal Government's investment adviser, Goldman, Sachs, has classified the Alleghany offer as 'within the range of reasonable compensation' and said it might serve as a floor in the bidding."

Now, are you saying the Newark paper was just off base?

Mr. ROONEY. No; that is probably an accurate quote, sir. But the point is, just that last phrase that you quoted, that it might serve as a floor—we certainly did not imply by any of our comments at that time that it constituted a ceiling. And in fact, Senator, the subsequent bidding did raise the bid quite considerably.

Senator METZENBAUM. The $1.2 billion.

Mr. ROONEY. No, Senator. Some of the other bids exceeded that.

Senator METZENBAUM. What was the highest bid you had?

Mr. ROONEY. Well, there were a number of bids which were very highly leveraged, and probably not appropriate within the circumstances, that went up in the $5 billion range—largely paying us with our own money, I might add. You are familiar with that technique, I am sure.

Senator METZENBAUM. Well, yes, I am. But it is interesting to me that if somebody can pay you $5 billion with your own money, then you sort of have to wonder whether or not that doesn't prove the point that some of us have made, that you had $800 million cash, you had a $250 million surplus in the pension funds, you had $3 billion to depreciate—$3 billion in assets—whether or not the $1.2 billion is a reasonable figure. I guess that is arguable, and I will not attempt to argue that with you now.

But I want to go back to this Memorandum of Intent. Now, when Norfolk Southern came in on June 18, they said that the obligation of Norfolk Southern to close shall be contingent upon satisfaction of the following conditions. And then, they talked about getting a favorable ruling from the Internal Revenue Service, in connection with four separate items. I will not repeat the four separate items.

I will say that I would like to know who was responsible for taking that proposal of theirs and changing it to the point where the agreement that you are submitting to us no longer provides for the Internal Revenue ruling; it provides for absolute guarantees on the part of the Federal Government as to what the tax results will be.

My point is that Norfolk Southern itself never even asked for that, and you gave it to them. And I am wondering on whose side the negotiator was, and who was the genius who took the language—what they said was "receipt of a favorable ruling of the Internal Revenue Service or, at Norfolk Southern's option, an opinion of its counsel on tax matters in either case acceptable to us." And then it spells out the four.

What I am saying is, you did not put that into the agreement. What you put into the agreement is if they do not get a favorable ruling, we, the U.S. Government, will guarantee that, or we will see to it that it comes about.

I am saying who——

The CHAIRMAN. He can answer that on the next round.

Senator METZENBAUM. Don't you want to let him answer on this one?

The CHAIRMAN. No; your time is up.

The distinguished Senator from Pennsylvania.

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Rooney, putting aside Christians and lions, let us deal with a Senator and an administrator, and try to move the essence of it face up to develop your detailed knowledge first, which might raise the issue as to whether a great many of these procedures were followed.

I would like to start with the Code of Federal Regulations, which sets forth in some detail the principles which guide this kind of a transaction—part 1180, Railroad Acquisition, Control, Merger, Consolidation Project—and a variety of considerations, which we may get to one-by-one, if necessary, on identity of lines—49 CFR 1186(a)(6); principal routes and termini—1186(a)(7)(vi); and proposed marketing plan—49 CFR 1187(d); and detailed operating plan, which has numerous subparts. Trying to cut through to the conclusions of the matter, based upon studies and information provided to me, my question to you is, isn't it true that the Department of Transportation did not at any time make an independent assessment of the transaction from the standpoint of its effect on employment facilities, train service, or the adequacy of rail transportation generally, but that the facts and figures that the Department of Transportation has been reciting were taken largely from materials supplied exclusively by Norfolk Southern?

Mr. ROONEY. Senator, we did a number of analyses. They were preliminary in nature, which is a point that is brought out in my testimony, which I did not get to read in entirety. We concluded preliminarily that the competitive implications of continuing Norfolk Southern as a bidder required attention, needed to be addressed; that we were not the appropriate body to make that assessment, and that we would refer these issues for resolution to the Antitrust Division of the Department of Justice.

I believe that our conclusions in the matter, as concerning bigness per se, the argument that some sort of a juggernaut in the East might be formed——

Senator SPECTER. I do not want to interrupt you, Mr. Rooney, but we have a very limited amount of time, and my question does not go to bigness or antitrust, or the issues which went to Justice. My question went to employment, facilities, and train service.

Now, that is my question. You talk about an analysis preliminary in nature. That sounds to me as if you just did not do it. You started to—preliminarily—but nothing that was thorough.

Mr. ROONEY. Well, you are citing a code, Senator, that pertains, I believe, to the Interstate Commerce Commission procedures. Is that correct?

Senator SPECTER. That is right. I am trying to find out——

Mr. ROONEY. That is the methodology which they follow——

Senator SPECTER. I am trying to find out if what Justice and DOT did here amounted to what is required by an ICC survey, which has not been undertaken. The Senate and this committee are being asked to give antitrust approval for studies mandated by law through the ICC, which simply have not been performed.

The Department of Justice is not making a representation that they have undertaken these types of studies. I am asking you about an independent assessment made by DOT as to employment, facilities and train services. If your answer is no, that you relied on Justice, then say so.

Mr. ROONEY. In sum, that is the answer, Senator, but you are placing me in a conundrum here by suggesting that that would have been an appropriate action.

Section 408(c) of NERSA says specifically, "No transfer of the corporation stock or rail properties and freight service responsibilities under this title shall be subjected to judicial review or review by the Commission." I think it was entirely appropriate to give this matter over to the highly independent, incidentally, and well-staffed Antitrust Division of the Justice Department.

Senator SPECTER. Well, that would be true to the antitrust questions, but not as to the questions which I am raising. If these questions have not been asked, and we are being requested to give approval on a matter which has not had an analysis on basic questions which would otherwise have gone to the ICC, that is what I want to find out so that we can make a judgment.

Let me move on to the second question, which is in summary form, that the results that have been reported—that is, 2,530 jobs abolished, and 1,150 route-miles abandoned—take into account only immediate or near-term changes, and not an analysis of operations which are expected over an extended period of time.

Now, my question to you is, did the Department of Transportation take any independent analysis on that subject matter?

Mr. ROONEY. Senator, we would make reference in such a situation to Conrail's own study of its potential for efficiency, which do call for impacts on employees over time.

Senator SPECTER. I am talking about the acquisition. I am not talking about Conrail. There has been a conclusion here that there would be only 2,530 jobs abolished, and 1,250 route-miles abandoned, not by Conrail but by Norfolk Southern after acquiring Conrail. My question to you is, did the Department of Transportation make an analysis—not something that is preliminary in nature, but something you will stand by as an analysis, which took into account what would happen over a projected period of time—3, 4, 5, 6 years—as well as near-term changes. Did DOT do that?

Mr. ROONEY. Senator, the only analysis we performed in that regard is to examine the effects of the divestitures on the figures you have cited. They are mitigating effects, of course.

Senator SPECTER. All right. I will take that answer to be in effect a "No".

Third, no data was obtained from railroads or others affected which would measure the impact of the integrated Norfolk Southern/Conrail operations on non-Norfolk Southern/Conrail employees, shippers, and communities.

The question here is, did you get data from other railroads, or others affected, which would have a measurement of that kind of a factor?

Mr. ROONEY. We have discussed with other railroads the diversion potential of this merger. We have also referred all of those railroads—and I believe they have spoken to the Department of Justice about exactly those same propositions.

Senator SPECTER. Well, if I have time, I am going to come back and ask you for the specifics. If I do not, I want you to provide the specifics to me of what railroads you talked to, when you talked to them, who did the talking, and what they said.

[The following was subsequently supplied for the record:]

Carriers Contacting DOT* Concerning Possible NS/CR Divestiture

Carrier	Date Contacted	Subject	Results*
Ann Arbor Railroad	3/1/85 and 3/6/85	Potential ability of of A.A. to contribute to or participate in divestitures; solving competitive problems DOT noted in Michigan and Ohio.	Referred to DOJ. Discussions held with DOJ.
Bessemer and Lake Erie (B&LE) Railroad	2/11/85	To hold exploratory discussion on B&LE's interest in acquiring portions of NS-Conrail's system. The B&LE representative indicated the need to talk to his principals before going further with the discussions.	No further expression of interest was made by the B&LE. The B&LE is negotiating with NS the reopening of gateways closed by Conrail.
Chicago and Northwestern Transportation Inc.	4/4/85 and prior correspondence	Exchanged views on diversions of traffic and maintenance of service agreements CNW has with Conrail.	Negotiating with NS to maintain cooperative service agreements now in force.
Delaware and Ostego System	1/18/85, 2/4/85 and subsequent contacts	D&O would not suffer direct loss. Concerned about keeping existing contractural relationships with Conrail in place and expanding service via trackage rights.	Contractual relationships will not be altered. Discussing service options with NS and Guilford.
Eastern Shore Railroad (ESHR)	8/16/84	Concern that NS might divert traffic away or fail to continue the high degree of support that CR had been giving.	NS assured ESHR officials of its intent to continue to route traffic over that line and to participate actively, as CR had been doing, in the economic development of the region.

*and Norfolk Southern and Guilford, where known.

Carriers Contacting DOT Concerning Possible NS/CR Divestiture (Cont.)

Carrier	Date Contacted	Subject	Results
Elgin, Joliet and Eastern Railway (EJE)	4/4/85	Desirous of NS-CR reopening gateways previously closed by CR (per MOI covenant)	Negotiations are being conducted between EJE and NS.
Genessee and Wyoming Railroad	2/4/85	Wanted to explore expanding its service area by acquiring trackage rights to various points in western New York.	Referred to DOJ study parameters.
Guilford Transportation Industries, Inc. (GTI)	Various times between 1/4/85 and 1/28/85	To discuss lines NS is interested in divesting and lines GTI was interested in acquiring.	On 2/25/85 NS and GTI announced execution of an Agreement in Principle regarding lines to be divested.
Illinois Central Gulf Railroad (ICG)	3/19/85, January and April meeting (date unknown)	To discuss areas which in ICG's traffic would be most impacted by a NS/CR merger.	ICG's desire to keep Effingham gateway open has been agreed to by NS. Not aware of outcome to other ICG desire that joint line rates be competitive with NS CR joint line rates.
Missouri-Kansas-Texas Railroad (MKT)	2/13/85	Proposed to investigate cooperative service arrangements with potential acquirers of divestitures. Also discussed diversion, potential detriments or benefits to MKT.	Holding discussions with Guilford and Grand Trunk.

Carriers Contacting DOT Concerning Possible NS/CR Divestiture (Cont.)

Carrier	Date Contacted	Subject	Results
Pittsburgh and Shawmut	2/4/85	Described proposed divestitures. They wanted to explore trackage rights, etc. to expand service territory.	Subsequently because part of Bessemer and Lake Erie's proposals to NS.
PRORAIL: Pittsburgh and Lake Erie (P&LE) and Grand Trunk Western (GTW)	1/2/85, 1/4/85, 1/15/85	To explore areas in the divestiture process in which these carriers might work cooperatively considering that all had expressed an interest in this DOJ requirement	On 2/25/85 NS and PLE announced execution of an Agreement in Principle regarding lines to be divested. NS is negotiating with GTW.
Richmond Fredericksburg and Potomac RR	4/16/85	Exchanged views on diversions of traffic. Explored ways to resolve RF&P problems.	Negotiating with NS.

Senator SPECTER. Now, with respect to an operating plan, which is a very important document under general principles for this kind of merger acquisition, the information provided to me is that the Department of Transportation has not retained in its files any analysis of a Norfolk Southern/Conrail operating plan. This gives rise to an inference that there has not been such an operating plan compiled of a combined operation of Norfolk Southern and Conrail.

I have two questions to you. Did the Department of Transportation analyze such a plan, and if so, is that plan currently in the files of Conrail?

Mr. ROONEY. Do you mean of the Department——

Senator SPECTER. Pardon me—of the Department of Transportation.

Mr. ROONEY. Senator, it is not currently in the files of the Department, and we did not analyze such a plan. Again, I believe the Department of Justice had access to such a plan.

Senator SPECTER. Information further provided to me is to the effect that no railroad competitors were informed of proposed changes that would affect them, nor were they asked to supply data to show what competitive impacts——

The CHAIRMAN. Your time is up, Senator.

Senator SPECTER. I shall return.

The CHAIRMAN. The distinguished Senator from Ohio.

Senator METZENBAUM. I think that the witness was about to respond to my question, and I do not know if he remembers it, but if he does not, I will see if I can remember it.

Do you remember the question, Mr. Rooney?

Mr. ROONEY. No, Senator, I do not. I am sorry.

Senator METZENBAUM. I think that the question pertained to the fact of how did it come about that Norfolk Southern in their proposal said that their obligation to close shall be "contingent upon satisfaction of the following conditions: receipt of a favorable ruling of the Internal Revenue Service or, at Norfolk Southern's option, an opinion of its counsel on tax matters, in either case acceptable to Norfolk Southern, including: (i) nonrecognition of gain or loss of income by Norfolk Southern . . . in connection with or as a consequence of the transfer; (ii) the tax basis of Conrail's assets; (iii) inclusion of Conrail as a member of the NS Consolidated Group by closing date, and the use of any losses of Conrail after the closing against income of Norfolk Southern Consolidated Group; and (iv) changes in Conrail's accounting and depreciation methods."

I will not ask you to go into each of those, but what concerns me is that they were asking you in their proposal that they could go to the IRS and qet a ruling, or that their lawyer would satisfy them with respect to some of those issues, but when the final document was drafted, there are specific guarantees on the part of the Government in connection with the matter of taxes. And they go to the point of saying that the Government warrants that if you cannot get it that way, the Government will indemnify.

Now, my question is who made the decision to give away so much of the store, when Norfolk Southern was not even asking for it?

Did you, or somebody else?

Mr. Rooney. Senator, I am going to ask two things of you this morning—first off, would you pose the rationale for the refusal of a ruling to the representatives of the Treasury Department who are here——

Senator Metzenbaum. To the what—I am sorry?

Mr. Rooney. The Internal Revenue Service was not moved by the requests for a ruling, Senator and did not conclude that it should give such rulings. Instead, the IRS suggested the course of events which has, in fact, taken place—namely, that it would propose a closing agreement for certain features: for example, the closing of the fiscal year, and the give-up of the NOL's and the ITC's. On balance, the IRS preferred that some other course be found.

Now, that other course, Senator, is nothing more nor less than a guarantee that normal tax procedures will occur——

Senator Metzenbaum. Not so. Not so, Mr. Rooney, because what was stated is, in paragraph 4: "The cancellation by seller on the date of closing of any interest of seller in any debt, including accrued interest there on and in preferred stock, including accrued and unpaid dividends thereon of Conrail held by seller shall not"—and this is an absolute statement—"shall not result in the recognition of gross income for the purposes of the code."

Nobody in business makes that kind of a deal, where they can say how the code will be interpreted. Only the U.S. Government can do that. That is what you did.

Then you went on: "The IRS may adjust the tax-value basis of Conrail's assets prior to closing, but Norfolk Southern shall receive a carryforward equal to the amount of any such reduction in the tax value of said assets"—a specific promise by the Government.

Page 3, paragraph 4: "That Conrail's net operating loss carryforwards shall not be available for carryover to taxable years beginning on or after the closing"—that was fine; but then there is an exception—"except to the extent such carryforwards are attributable solely to reductions required by the IRS in the adjusted tax basis of Conrail's depreciable or amortizable assets as reflected in its U.S. corporation income tax return for the taxable year ending on the closing."

The IRS may not adjust the tax value basis of Conrail's assets after closing because, on page 4, paragraph 6(e), subparagraph 2, "The adjusted basis at closing of Conrail's and its affiliates' depreciable or amortizable assets shall be as shown on its U.S. corporation income tax return for the taxable year ending on the closing, determined without extraordinary departures from the methods of prior years, and said basis as of closing shall not thereafter be increased or decreased as a result of any adjustment to a taxable year of Conrail ending on or before the closing."

Page 3, paragraph 4 has another guarantee of the Government.

Page 4, paragraph 6 has another guarantee of the Government.

Page 4, paragraph 6(e)(2) through subparagraph (3) and (4) have other guarantees of the Government.

Page 10, paragraph 10(d) has another guarantee of the Government.

And in addition to everything else, it provides that "If any of the representations contained in the Memorandum of Intent to sell Conrail are breached by the United States, Norfolk Southern is given a special right to sue in district court or the Court of Claims," and that is to be found in the contract, as well.

Now, what I am saying to you is that Norfolk Southern never even had the audacity to come in and ask for these kinds of guarantees from the U.S. Government. You people gave them those guarantees in the negotiations. Now, you come to the Congress of the United States and ask us to rubberstamp those guarantees. And I am asking you who was the person or persons who decided, made these decisions, to include these guarantees for the buyer, that the buyer itself had never asked for? Did you?

Mr. ROONEY. Senator, I think the accurate representation is we made them in consultation with the Treasury Department. I would love to be able to rebut each of those points that you made earlier, and if you will permit me, I would be happy to provide in writing the usual tax treatment which is, I am afraid—from our point of view, at least—perfectly consistent with the guarantees you have given.

If you sell a business, Senator, and you represent that you have accurately filed your tax returns, it is customary to provide some sort of a representation and warranty, even to escrow, Senator, a portion of the proceeds.

Senator METZENBAUM. Mr. Rooney, you do not need to teach me that aspect of business negotiations. I understand that. We are not talking about misrepresentations of your tax position. We are talking about how this business transaction will be handled. And I do not know of any business transaction where the seller guarantees the buyer as to how the transaction will be handled by the IRS.

As a matter of fact, you put out a fact sheet. In that, you claim that the built-in loss rule will preclude Norfolk Southern from transferring Conrail tax writeoffs to offset Norfolk income.

Is that still your understanding of the tax law?

Mr. ROONEY. Senator, in general terms, the workings of the built-in loss deduction limitation rules would do precisely that. They would limit the built-in loss deductions to the subsidiary level.

Senator METZENBAUM. Is it your understanding that Norfolk Southern agrees with you? Do you know that their lawyers have advised us that they do not agree with you?

Mr. ROONEY. I heard you say that last week, Senator. I would simply say that I would attempt not to abridge the right of the IRS vigorously to oppose their position on that matter, Senator. There is obviously a matter of opinion there. They said they would take a business risk at trying to prove that the difference on their fair market value purchase on the tax basis would be de minimus.

Senator METZENBAUM. Well, as a matter of fact, Treasury disagrees with you. Treasury's statement, which will be given subsequently, starts off by saying—or at least, at one point, says—"If Norfolk can use Conrail's tax benefits, it would have an adverse impact on revenues." That is a quote from the——

Mr. ROONEY. If indeed they could pass the de minimus test, Senator, you are right, you are correct; they would perhaps be able to use Conrail's excess, if there are excess, deductions at the current level.

Senator METZENBAUM. And, let me just finish this, Mr. Chairman. The Treasury also says that there is a de minimus exception:

"Since we do not have appraisals or other direct information concerning the fair market value of Conrail's assets, it is not certain that Conrail would not satisfy the de minimus exception."

What was your authority for indicating what the Treasury interpretation would be? Had they advised you on the point?

Mr. ROONEY. We frequently discuss these topics with Treasury, sir, and they proposed only that existing law—and we proposed only that existing law—be allowed to operate. That is all that is going on here. These de minimus tests and the built-in deduction limitations are a matter of statute. We have not provided Norfolk Southern any unusual, arbitrarily conceived tax benefits in this proposal.

Senator METZENBAUM. But your fact sheet indicates a positive statement——

The CHAIRMAN. The Senator from Kentucky.

Senator McCONNELL. Thank you, Mr. Chairman.

I would like to ask unanimous consent that an opening statement that I have prepared appear in the record at this point.

The CHAIRMAN. Without objection, so ordered.

[The following was received for the record:]

OPENING STATEMENT OF SENATOR MITCH McCONNELL

Mr. Chairman, I have learned more about the railroad business in the past couple of months than I ever thought possible. Yet, I am still sifting through the volumes of material on this issue to reach a conclusion which I believe is in the public's best interest and, particularly, the best interests of my constituents.

My indecision rests, in part, on the conflicting information which I have received. Norkolk Southern says that the sale will help shippers. Other carriers maintain that it will have a devastating impact on the coal industry and other shippers. The Justice Department has argued that the resulting efficiencies are "likely to be sufficiently great to offset the less significant adverse competitive effects that would remain after divestiture." This was the Justice Department's conclusion even though it recognized that a number of the efficiencies could be achieved even in the absence of a merger.

I am waiting to be convinced that the projected efficiencies would, in fact, outweigh the loss in competition. Based upon interviews with selected shippers, Justice contends that substantial benefits will result from single-line service which is usually less costly to railroads and more desirable to shippers. This would make sense for the short term. But what about over the long term?

Some have argued that the newly created system will be able to divert so much traffic from other carriers that those carriers will be unable to compete effectively. And if this becomes the case, then shippers might be in a worse fix over the long-term.

This is a possibility we should consider. Hopefully, the testimony we hear today will answer our concerns about the impact the proposed merger would have on shippers.

Senator McCONNELL. Mr. Rooney, the Senate Budget Committee has assumed a savings of $1.2 billion in fiscal year 1986 by the sale of Conrail. The sale price is $1.2 billion, whereby Norfolk Southern will obtain a profitable Conrail with $800 million cash onhand. So in effect, the Government, it seems to me, will be getting only $400 million for its rather large investment.

At the same time, the Government will forgive approximately $3.3 billion in debt incurred by Conrail. Won't that $3.3 billion now show up on the books as an outlay, since in effect, it is being forgiven, and if that is the case, could it not be persuasively argued that in effect, what we are doing here is increasing the deficit by $2.9

billion, rather than reducing it by $1.2 billion, in making this transaction?

Mr. ROONEY. Senator, I am afraid I am not a budget analyst, or enough of one, to tell you the result of that. I would be happy to get you an answer and provide it for the record.

Senator McCONNELL. Does it require a budget analyst to——

Mr. ROONEY. I frankly do not know how they plan to treat the debt retirement on the books.

Senator McCONNELL. Does it not appear to you to be a $2.9 billion loss, rather than $1.2 billion that we could add in to next year's budget?

Mr. ROONEY. The question would run more to who holds the debt, and more particularly, what the value of that debt is, whether it is liquidating value or what-have-you.

Senator McCONNELL. Well, I would like for somebody to supply an answer to that. Maybe you are not the right one.

The CHAIRMAN. Who could answer that for him—the IRS?

Mr. ROONEY. No; Mr. Chairman. I will attempt to get that answer for the Senator and provide it.

The one point I would make, however, Senator McConnell, is that it is quite clear in NERSA that the debt was to be forgiven. That is not a brand new concept.

Senator McCONNELL. So it is clear that it was to be forgiven?

Mr. ROONEY. Yes, sir, as a matter of facilitating the sale of the company, the debt and the preferred stock were to be expunged.

Senator McCONNELL. Which would tend to argue that we are, in fact, increasing the deficit by $2.9 billion by making the transaction?

Mr. ROONEY. Right.

[The following was subsequently supplied for the record:]

QUESTION: The Administration is forgiving $3.2 billion of Conrail's debt owed to the Federal Government. The Administration is selling Conrail for $1.2 or 1.3 billion. Therefore, won't the sale increase the deficit by $1.9 billion?

ANSWER: No. Cancelling and retiring the debt and preferred stock will not add anything to the Federal deficit. The amount of the debt and the preferred stock was added to the deficit when funds were appropriated to USRA under section 216(g) of the Regional Rail Reorganization Act of 1973 to acquire Conrail's debentures and series A preferred stock.

- Because the funds for the debt and the preferred stock were appropriated to USRA, the Treasury does not even have a receivable on the books. Thus, the Federal budget does not anticipate repayment of the debt or retirement of the preferred stock, and elimination of either or both of them would not change the Federal deficit.
- The Government is forgiving the debt and retiring the preferred stock in order to make the Government's common stock marketable. Unless we eliminate the debt and preferred stock, we cannot carry out NERSA's mandate to sell the Government's common stock interest in Conrail and we are unlikely to get any significant return at all for the public investment in Conrail.

BACKGROUND: USRA has a receivable for the debt and carries the preferred stock on its books in a unique category of its own as neither debt nor equity. USRA carries both securities at par value of about $851 million and $2.555 billion, respectively. If the debt were repaid to USRA and the preferred stock retired by Conrail, USRA would be required to deposit the proceeds in the general fund of the Treasury. That payment would reduce the deficit.

Senator McConnell. On page 8 of your statement, you have a chart, suggesting that to merge the Norfolk Southern/Conrail system would put it on a relatively equal footing with CSX in terms of tons of traffic, carloads, et cetera. The new combined carrier would have 22,000 more miles of track, 2,000 more leased or owned locomotives, and 21,000 more employees. Yet your chart shows that it would only handle 14 million more tons. I am wondering if you can explain that to me. Your chart is on 7, and then again on 8—why only 14 million more tons would be handled when the new railroad is so much larger.

Mr. Rooney. Well, Senator, a lot of the operations of, for example, the Southern Railway component of Norfolk Southern, are on relatively light-density lines, and therefore track mileage and tonnage do not necessarily correlate one-for-one.

Senator McConnell. Does your chart account for the traffic which might be diverted from increased competition?

Mr. Rooney. No, Senator, I do not believe it does. This is a prediversionary chart.

Senator McConnell. Well, why doesn't it, then?

Mr. Rooney. These numbers were prepared in a staff analysis that came into being prior to the divestiture scheme that has been announced.

The Chairman. If your counsel is more familiar with it, you can let him answer. In other words, we want the benefit of the answers to these questions, if we can get them.

Mr. Rooney. The counselor is not more familiar with these numbers, Senator.

Senator McConnell. So much for you, Counselor. [Laughter.]

Didn't DOT conduct a study of what diversions might occur?

Mr. Rooney. Senator—yes, we have conducted a study. We did conduct a primary study of diversion.

Senator McConnell. What were the estimates?

Mr. Rooney. Over a broad range of carriers—in fact, all of the major carriers in the country—our study concluded that on a liberal interpretation basis, revenue implications of the entire merger would be on the order of $185 to $200 million, and on a conservative—that is to say, turning the world upside down and saying you make the most conservative estimate of traffic that might be diverted—you have a result in the $130 million area.

In each case, that equates in carloads of traffic to something less than one percent of the total rail traffic moving in the East.

Senator McConnell. So it would not be on an equal footing, then?

Mr. Rooney. Who would not be on an equal footing? I was giving you aggregate numbers, Senator, for all the diversions from all the railroads interconnecting with and operating in the same territory, and I was giving you revenue dollar estimates.

Senator McConnell. OK, thank you. No further questions.

The Chairman. The distinguished Senator from Delaware.

Senator Biden. Mr. Chairman, I have been in the foreign assistance markup, and I have a series of amendments on narcotics control, and I just got a call saying that my amendments are up, and I am going to have to leave again, and I am sure it will please the witness to know that I will yield to the Senator from Ohio. [Laughter.]

I will put my questions in the record. I hope to be able to come back down before the witnesses are gone to pursue my questions, but at this moment, I have to leave.

The CHAIRMAN. Thank you.

[The following was received for the record:]

Biden #1

QUESTION:

Gentlemen, let me ask you a serious question about the timing of the sale of Conrail. In 1984, Conrail had earnings of about $500 million. In 1985, it is projected that net income will be approximately $478 million, on revenues of approximately $3.4 billion. The company has accumulated almost $850 million in cash. At this time, it seems Conrail is earning money for the Federal Government at quite a healthy pace. Why is it so important to the Department of Transportation, and presumably to the Reagan Administration, that Conrail be sold at this time?

ANSWER:

Conrail is doing well, and certainly its improvement has been one of the great turnaround stories of modern times. However, it is not in the public interest for the Congress to delay unnecessarily when the opportunity exists to execute a sale that meets the public interest criteria. There are several reasons why:

- Market conditions today are optimal from a seller's perspective. The economy is strong, interest rates are stable. In 1984, Conrail registered the best year it expects for the next three. (According to USRA's report, Outlook For Conrail, in each of the next three years, Conrail will record lower profits than it did in 1984.) Delaying a Conrail sale, when there are acceptable options, forces taxpayers to speculate on the future course of the economy, on Conrail's future performance, on truck and rail competition, and on legislative matters that bear on Conrail's future, such as the threat of re-regulation and change in the tax code.

- The states served by Conrail lose between $25 and $60 million in taxes each year that Conrail remains in Government ownership. A sum of $2 to $5 million per month in foregone taxes is a high price for these states to pay for delay.

- Sale would eliminate the Federal government's subsidization of Conrail's labor protection payment.

- Foregone interest on the $1.2 billion plus in cash that the Government would receive is continuing to increase the Federal deficit.

- Acceptance of a plan would make Conrail a potential taxpayer on the date of the sale, because Conrail would no longer be able to use its accumulated net operating loss carryforwards and investment credits to shelter its earnings from taxes as it does now. These would be surrendered.

- The value of $1.2 billion received today in comparison to the present value of future receipts of an unknown amount is a cost to the Government.

- The Administration and the Congress have an obligation to do everything they can to resolve the uncertainties now facing shippers, employees, and communities being served by the Conrail system.

- Cancellation of this extensive sale process which has required considerable effort on the part of many bidders would taint credibility for starting another similar process in the future.

- In the final analysis, the potential for future receipts from a sale to exceed money in hand now is less than even odds, perhaps significantly less, in view of declining earnings prospects and the fact that Conrail must continue to make very substantial capital investments to keep its property in shape.

Biden #2

QUESTION:

Besides the Administration's intent to pursue deregulation, isn't the recommended sale of Conrail viewed as a means of at least partially reducing the federal budget deficit? If this is the intention, why can't Conrail begin to pay back to the federal government, through its earnings, some of the debt which is owed the American taxpayer? Reserving enough cash to meet the company's operating needs (probably $500 to $600 million), why can't Conrail contribute to reducing the federal deficit in this manner?

ANSWER:

We have examined Conrail's earnings and the projections prepared by the United States Railway Association in its April 1985 Outlook for Conrail. Based on previous and projected earnings and Conrail's Articles of Incorporation, Conrail's first payment to the Government of cash interest on the Conrail debentures which the Government holds would occur in 1989. The net present value of that payment is $135 million when one considers that the Government currently has to pay 11.2 percent on debt of that duration.

When Conrail would be able to begin retiring these debentures (not required until the year 2011) is unknown, but it would probably be several years after 1989.

Finally, let me sum up by saying that the Federal government is not receiving one cent from Conrail at this time, but is instead paying to subsidize Conrail's labor protection program.

Biden #3

QUESTION:

Norfolk Southern will be able to possibly recoup its $1.2 million cash outlay through depreciating Conrail assets over a very short period of time. I recognize that Norfolk Southern will only be taking advantage of provisions in the Tax Code which are also available to every other American corporation. However, in this instance, the American people have paid over $7 billion to establish Conrail and to keep it running. The fact that Norfolk Southern will "inherit" this public investment is a little different than what normally is the case in the private sector. How do you react to this "windfall" and what do you think can be done? Do you think it's fair that Norfolk Southern may actually end up paying next to nothing for this valuable government asset?

ANSWER:

Norfolk Southern is purchasing Conrail including $3 billion in asset basis that can be depreciated. In a normal private sector stock purchase transaction, the purchaser would also be receiving the net operating loss and investment tax credit carryforwards as well. The asset basis that Norfolk Southern is acquiring is almost exactly the same as the basis that Conrail had on April 1, 1976. The government's investment, and any other capital improvements that Conrail has made over the last eight years has only been sufficient to maintain Conrail's asset base at its original level.

Norfolk Southern has offered the best price of all of the bids we have received. We have been unable to obtain any better offer which offers the same credibility and package of guarantees to shippers, employees, and communities. We do not know to what extent Norfolk Southern may be able to use any of Conrail's depreciation to reduce its own income, but the Department of Treasury is currently conducting a study to illustrate the possible use

Biden #4

QUESTION:

Norfolk Southern may also end up paying no taxes on account of the forgiveness of almost $850 million in debt to the Federal government. In other words, under the terms of the Memorandum of Intent, this will not be a taxable event. Did Congress make a mistake in writing this provision into the Northeast Rail Service Act in 1981 and should we go back and reconsider this issue? It seems to me that Congress had in mind a company that was really struggling to stay afloat, not one that has accumulated close to $1 billion in cash.

ANSWER:

The forgiveness of the government debt was provided for in NERSA because it was believed that Conrail could not be sold with the government debt. We agree totally with that decision. It is unlikely that we could sell Conrail at all with the Government debt and preferred stock in place. It is a certainty that the price we would receive from the sale would be much less than what we have on the table currently.

Conrail's earnings and cash flow as a government-owned company with all of the benefits that Conrail enjoys--nonpayment of state taxes, the reduced expenses associated with labor concessions, government subsidy of its labor protection costs, expedited abandonments, and no federal income tax liability--has been impressive. It has been particularly impressive when compared to pre-1981 results.

However, Conrail's earnings adjusted to reflect what it would have earned as a private company are much more modest. It would have lost substantial sums of money in 1981 and 1982, made only about $80 million in 1983 and $300 million in 1984. Prospects for the future are not as bright. The projections USRA included in its April 1, 1985 report, Outlook for Conrail, indicate that Conrail's positive cash flow over the next four years will only total $243 million, of which over half is projected to occur in 1985.

We are talking about a company that currently has, and is projected in the future, to have very modest earnings and cash flow. The USRA projections totally disregard any payments of principal or interest on any debt or dividends on any stock. The fragile financial picture that USRA paints does not permit such payments without producing a negative cash flow.

If we offered Conrail for sale with the government debt and preferred stock kept in place, and all prospects for negative cash flow for the forseeable future, there would be very few potential buyers, and the possibility of the government getting the entire company back on its doorstep through some bankruptcy or insolvency proceeding would be high.

In summary, the Congress made a decision with regard to forgiveness of the debt that was totally consistent with its decision to return Conrail to the private sector. Without this provision in the law, as well as those which have provided the wherewithal for Conrail to have profits and positive cash flows, there would have been no need to provide for a sale, because there would have been no buyers.

Biden #5

QUESTION:

You have said in previous testimony and again here today, that DOT rejected the idea of a public offering of Conrail stock very early on. Could you explain why that was so? Would you change your mind if there was an actual commitment to underwrite such an offering? Why, in your opinion, has such a commitment failed to materialize?

ANSWER:

We, and our investment advisor, Goldman Sachs, have never been opposed in principle to a public offering. However, we both agree and, Goldman Sachs has consistently advised us, that the objectives sought by the Department in this unique transaction can best be met through a negotiated sale to a known party.

We, and Goldman Sachs at our request, have explored the feasibility of a public offering. We did so in order to:

- weigh every possible pro and con of the public offering format, and
- be prepared to address that option should no private purchaser come forward.

The results of our examination led us to conclude that a public offering of Conrail shares would be less effective than our negotiated sale process in protecting the public interest in financial and nonfinancial aspects of the sale while maximizing the return on the taxpayers' investment.

A commitment to underwrite an amount in excess of the offer we have before us would have to meet concerns that were not met by the Conrail management proposal (which only proposed a public offering of $1.1 billion):

- public interest covenants to protect Conrail's financial strength and its capacity to meet its service obligations without risking reducing the share price so as to violate our criterion of maximizing return.
- No substantial drain on Conrail's financial strength from either debt service or the obligation to pay dividends on preferred stock and common stock.
- Elimination of all risk to the Government that the initial public offering may not yield the projected return.
- No requirement of additional significant expenditures by the Government or Conrail to accomplish the public offerings.
- No restrictions on stock ownership that dilute management's actual or potential accountability to shareholders.
- Knowledge of to whom we are selling Conrail so that we can make fundamental judgements on the adequacy of the

buyer's finances with respect to his ability to execute the sale and to fulfill his commitment to continue rail service.

- No risk that the Government would be left a shareholder for an indefinite period of time while the stock is issued in several installments.

Additionally, to cancel the sale process now in order to pursue a pure public offering would be a grave disservice to the parties who made large investments of dollars and management time in the current purchase process. More importantly, Conrail's employees who have already endured several years of uncertainty about the future of the company, would face another extended period of discussions that could have a profound impact on their careers and personal lives.

Biden #6

QUESTION:

The terms of the Memorandum of Intent provide for the negotiation, execution and delivery of a so-called "definitive agreement" following Congressional approval of enabling legislation. Among other things, this definitive agreement would set forth the final arrangements for Conrail's employees, including the valuation of the employees' beneficial interest in Conrail and labor protection provision. Isn't Congress being called on to act somewhat prematurely? Why wouldn't it be appropriate for Congress to wait and act on the final "definitive agreement?" This may be the only and best protection Conrail's employees have.

ANSWER:

The Definitive Agreement will implement and conform to the Memorandum of Intent ("MOI"). The Secretary will receive authority to enter into the Definitive Agreement from the pending legislation.

The MOI sets forth all of the material provisions that may ultimately be contained in the Definitive Agreement and provides a substantive basis for Congressional understanding of the transaction and legislative action. Most legislative authorizations are based on less detail than the proposed sale of Conrail to Norfolk Southern. Examples include the formations of Conrail, Amtrak and the sales of bankrupt railroads.

As for the final arrangements for Conrail's employees, although it is necessary that there be an agreement between labor and NS, it is not necessary for Congress to wait until this agreement has been reached. NS's offer to labor compares favorably with the proposal that Alleghany made to labor. One might reasonably expect that an eventual agreement with labor will be generally similar to NS's proposal. It seems highly unlikely, for example, that such an agreement would result in any substantial threat to Conrail's financial strength. The NS labor proposal has been considered in preparing financial projections for the NS-Conrail combination.

By the same token, paragraph 2 of the Memorandum of Intent sets out clearly, and in some detail, as a provision or contemporaneous condition of closing, that the buyers shall have made appropriate arrangements for agreement and nonagreement employees. The countervailing bargaining leverage this provision intentionally conveys to the employees and the fact that they must agree to any arrangements made on their behalf provide the best possible assurances that a deal can not be struck without satisfactorily addressing the employees' beneficial interests and rights to labor protection compensation.

Biden #7

QUESTION:

What assurances, if any, does Congress have that Norfolk Southern (1) will not resell Conrail? (2) will not "spin off" Conrail to NS shareholder? and (3) will not itself be the target of a successful takeover?

ANSWER:

The covenants prevent NS for five years from relinquishing a controlling interest in Conrail or from selling all or any substantial part of Conrail's assets. NS has stated publicly its intention to retain all of Conrail's common stock so that Conrail is a wholly owned subsidiary.

A spin-off of more than 50 percent of Conrail's stock would violate the control-retention covenant.

The MOI does not address the ownership of Norfolk Southern itself and does not attempt to insulate NS from takeover attempts.

Biden #8

QUESTION:

One of the affirmative covenants Norfolk Southern has agreed to enter into provides that the merged company will maintain or re-establish with the small eastern rail carriers reasonably direct and cost-competitive routes of major importance. The Delmarva Peninsula Line certainly falls within this category. What kind of arrangements will Norfolk Southern make in this case?

ANSWER:

At a meeting on August 16, 1984, sponsored by the management of the Eastern Shore Railroad, Inc., representatives of the Norfolk Southern Corporation gave assurances that they will continue rail service over Conrail's Delmarva line essentially as it exists today. In addition, assurances have been given to Maryland officials, that NS will not cherry-pick lines south of Wilmington. The Maryland and Delaware Railroad in Maryland has endorsed the Norfolk Southern offer.

Norfolk Southern already works closely with the Eastern Shore Railroad and has diverted some traffic from its long haul route via Potomac Yard to a short haul route via Eastern Shore Railroad at Norfolk. Norfolk Southern has stated that it will continue to work with the Eastern Shore Railroad wherever it can do so at a profit.

Biden #9

QUESTION:

The Federal government has invested $2.19 billion in much of the track which is owned by Amtrak but used by Conrail between Washington, DC and Boston. What would happen to this track if Amtrak was elminated as the Administration has proposed? Would it be available to Conrail while bankruptcy proceedings took place to settle the debts Amtrak would owe?

ANSWER:

The Northeast Corridor is the single area where it is most likely that Amtrak service could be run without Federal government subsidy. Even though the Department views the loss of Northeast Corridor Amtrak service as a remote possibility, public and private groups would likely find it economically worthwhile to acquire Northeast Corridor trackage and facilities to continue all or some of the existing operations.

The fees which Conrail and the various commuter agencies pay Amtrak for the use of the Northeast Corridor are a very substantial input to the total receipts of that corridor. If Amtrak were to enter reorganization proceedings, the trustee would have every incentive to continue receiving them and no incentive to eschew these payments by foreclosing service.

We believe this track should remain usable to Conrail should Amtrak enter bankruptcy proceedings. Under similar circumstances, Conrail's predecessors maintained freight operations during their bankruptcy and reorganization proceedings.

Biden #10

QUESTION:

If Amtrak was eliminated, would the track it owns and operates jointly with Conrail remain under the control of a single owner or could different portions be sold to separate buyers? Do you foresee any problems to having divided ownership of the Northeast Corridor tracks?

ANSWER:

Conrail and Amtrak do not own any trackage jointly. They do however, operate trackage jointly. If any of this Amtrak-owned trackage were sold to another party other than Conrail, we would expect that operations could continue as they are now presently being conducted between Conrail and the new owner.

It is conceivable that the Northeast Corridor could be sold to several different buyers. However, the operational difficulties that would be encountered as a result would probably forestall such a sale. This results because the Northeast Corridor has a differing number of tracks over various segments and it is necessary to coordinate the movement between segments from a central source. It is conceivable that the Northeast Corridor could be sold to several different joint parties who could operate it as a joint venture from a central source.

Biden #11

QUESTION:

If Conrail was able to take over the tracks it needs to serve its customers in the Northeast Corridor, it would have to pay increased costs to maintain and operate the tracks. What would this do to the competitive environment for transportation in the region? Would truckers carry more goods? Is there a possibility that shipments might be diverted to areas outside the Northeast Corridor region, such as coal shipments going through Norfolk instead of Baltimore or Philadelphia?

ANSWER:

If Conrail took over the tracks it needs to serve its customers in the Northeast Corridor, there should be no appreciable effects on rail transportation in the Northeast. Other lines that are currently using the corridor could continue to do so assuming they were willing to continue to pay appropriate fees.

We cannot estimate, if Conrail took over the corridor, whether or not it could generate revenues sufficient to cover costs of maintenance and operations at current levels. This would depend on the manner in which Conrail is reimbursed for passenger service. It would be assumed that Conrail would not agree to take over service on the corridor unless it would be able to cover the additional expenses involved. Otherwise, Conrail would scale back operations to the point dictated by its revenues plus those from passenger reimbursements. If this is the case, prices to shippers should remain the same, eliminating the need for diverting this traffic to trucks.

We also do not foresee the possibility that shipments might be diverted outside the corridor, especially coal shipments. The distribution of traffic among ports is shaped by economic factors, and those factors should not change if the ownership of the corridor changes. With respect to coal moving to ports for export, its origins are inland and its routing is normally not over the Northeast Corridor.

Biden #12

QUESTION:

If the Northeast Corridor track was put up for sale to pay Amtrak debts, who are the potential buyers? How much would it sell for? Would buyers be limited to those who are going to use the track or would any outsider investors be eligible?

ANSWER:

Should the Government be forced to sell the Northeast Corridor track under existing conditions and without any legislative input from Congress, the Government would attempt to develop a sale plan that would protect the public interest and maximize its return on the $2.19 billion that it has invested.

We would envision a sale process similar to the one that was used to sell Conrail, with purchasers sought from railroads, or other parties that might be interested in purchasing it as an investment. We do not currently have any idea concerning the actual price that the Northeast Corridor could bring on the open market. However, we would hope that by using a competitive bidding process, we would maximize the return to the Government.

Congress, should it desire, could also direct the Department to sell the Northeast Corridor through specific legislation that would govern ownership and the sale process.

The **Chairman**. The distinguished Senator from Ohio.

Senator **Metzenbaum**. I thank the distinguished Senator from Delaware.

Mr. Rooney, when the final plan is submitted, what evidence will you provide the committee to demonstrate that there will be viable competitive service available to those areas presently served?

Mr. **Rooney**. Senator, I would conclude that the Justice Department would make available to the committee that evidence which it had collected. It plans to ask for extensive operating plans from those carriers. To the extent that these plans would help the Committee's deliberations, I am sure that the carriers themselves would be happy to present them. They will undoubtedly study the potential for traffic, the traffic that exists there, the cost of carrying the traffic that exists there now, the cost of carrying the traffic that would come by virtue of their ability to compete over longer distances, and so on.

Senator **Metzenbaum**. You are saying that is what the Department of Justice would expect we will get?

Mr. **Rooney**. Yes; I am sure they would, and they would study that in order to determine the long-term viability of these people. That was a premise, you know, that they put on the thing.

Senator **Metzenbaum**. All right. Now, most rail mergers are subject to a full review by the ICC, with an opportunity for interested parties to participate. If, in fact, the Department of Justice study is the equivalent of a merger proceeding at the ICC, are you in a position to provide for the record the following documents normally required under such a procedure: First, an executive summary of the merger; second, the operating plan; third, traffic studies; fourth, Norfolk Southern's 3-year pro forma balance sheet with the source and application of funds; fifth, the labor impact analysis?

Mr. **Rooney**. Senator, I have stated already that we do not have such a plan from the Norfolk Southern and have not studied it; that we are dependent upon the Department of Justice to do that.

Senator **Metzenbaum**. The Interstate Commerce Commission is structured as a totally independent body, not subject to being a part of the politics of whomsoever may be in the administration at the moment. Now, we are talking about the Attorney General's approval being an effective substitute for the views of an independent Commission. Don't you believe, Mr. Rooney, that failure to submit this matter to the ICC but rather, submitting it to another arm of the Government, when one arm of the Government is attempting to sell it, does not provide for that impartiality of analysis that an ICC procedure would normally contemplate? And don't you believe it would have been better to provide that it would be submitted to the ICC, perhaps on an expedited basis?

Mr. **Rooney**. Senator, in that regard, we are quite literally following the dictates of Congress in that respect, section 408(c) of the Northeast Rail Services Act does declare that there will not be an Interstate Commerce Commission review. That leaves us with a number of courses of action—doing it ourselves, picking another impartial body; we chose the Justice Department.

In addition, Senator, no doubt Congress concluded that it would itself hold substantial deliberations, as we are doing here today, which would expose to the public record those kinds of differences of opinion that you are attempting to get out here, and that a judgment could be made after due deliberation by Congress and the weighing of all the facts.

Consequently, they erected this kind of a procedure. It was not we who declared the procedure, it was the Congress.

Senator METZENBAUM. Now, we have had considerable testimony as to the financial stability or lack of stability of P&LE and Guilford. In your opinion, what is going to happen if these divested lines cannot compete, and shippers are faced with only two major lines, or in many cases just one line, to provide essential rail service? What will happen to the shippers and the workers if these lines fail? Will the Government have to step back in and bail out P&LE and Guilford?

Mr. ROONEY. Senator, the first premise I would make is that the Department does not conclude that Guilford and the P&LE would fail. The divested lines are well configured to meet their needs. In fact, the Pittsburgh and Lake Erie may well fail without the curative measures that these line divestitures provide it. The notion may be turned around and the point put, that perhaps we will become an unwilling recipient of the problems of the P&LE, if we do not do something to fix its problems and those of the other regional carriers in the region. Those regional railroads must be given windows to the world and an economic interest in a trunkline system.

Senator METZENBAUM. Well, wouldn't you be willing to stipulate that P&LE and Guilford certainly are not financially in a position to provide the same kind of effective competition to Norfolk Southern that Conrail presently does?

Mr. ROONEY. Senator, I would make these points on that score. First off, those lines which the Guilford group plan to acquire would complement its system very considerably. It has large amounts of traffic which now must move over its direct competitors, to and from its service territory.

Guilford has already proven the capability to raise capital to purchase these lines in that it was a finalist in the Conrail purchase situation, and——

Senator METZENBAUM. P&LE was?

Mr. ROONEY [continuing]. No; the Guilford interest was—and finally, sir, it has purchased these railroads and contributed to the rehabilitation of the Delaware and Hudson unit of Guilford with its own funds. The rehabilitation on these lines would clearly be within its capability.

As to the Pittsburgh and Lake Erie, Senator, the Pittsburgh and Lake Erie proposes to acquire these lines via an infusion of new equity capital from external sources. That, combined with the ability to use this great surplus of equipment that it has purchased to serve business which is now foreclosed to it by the closure of gateways and the abandonment of joint rate concepts, will provide P&LE with a very substantial increment and business activity.

Senator METZENBAUM. You said the Guilford had proven that they were financially strong enough by reason of the fact that they made the proposal and indicated they could raise the money to be a final competitor. They indicate, or the figures I have indicate, that they have a $1.1 million working capital deficit. When I asked the president, I think it was, of Guilford the other day when he appeared before us what their net worth was, he was unable to tell me. What do you know that he did not know about their financial ability? Tell me what you know to indicate that they are financially stable.

Mr. ROONEY. Senator, I believe he indicated, that the railroads are operating on a positive cash-flow basis.

Senator METZENBAUM. Isn't that the fact only for one year?

Mr. ROONEY. In fact, the Delaware and Hudson is a 1-year proposition on that matter. The others are not; they have a history of operations.

I believe the $1.1 million you mentioned earlier is a net working capital figure for the Delaware & Hudson; is it not?

Senator METZENBAUM. Not according to what I have here, that was supplied to us by Conrail. I cannot vouch for the accuracy of it, but it is a comparison of P&LE, Guilford, and the combined Conrail/Norfolk system.

I might say to you that this gentleman who appeared before us, my staff asked him again yesterday what the company's net worth was, or is, and he said he still does not know. And I am asking you what do you know about their financial stability that the president of the company does not know. And I must tell you that I am nonplussed to have somebody come before the committee as a witness for a large corporation saying that they can buy something and not know their net worth. He might not know if it was $6 million or $16 million, but he would sure know if it was $60 million.

Mr. ROONEY. Senator, I think I was aware that he said to you that he would provide his audited figures as soon as they were available, and that would be roughly equivalent to the information we would have when they become available.

The CHAIRMAN. The gentleman's time has expired.

The Senator from Pennsylvania.

Senator SPECTER. Thank you, Mr. Chairman.

Mr. Rooney, perhaps we can cut a good bit of this short. You said that as to the operating plan, the Department of Transportation did not have that, but relied upon the Department of Justice. Did the same thing apply to the requirements of the Code of Federal Regulations, 1188(d), referring to the analyses concerning the consolidated companies' marketing plan—did you examine that, or did you leave that to the Department of Justice, as well?

Mr. ROONEY. Yes, sir.

Senator SPECTER. You left it to the Department of Justice.

And the provisions of 1180(c)(a)(2) of the detailed determination of the effect of the proposed transaction upon employees by craft and class—left, again, to the Department of Justice?

Mr. ROONEY. Senator, the effect on employees has been made a matter of public record by the Norfolk Southern. They have declared what the effect on employees would be.

Senator SPECTER. I know that, but my question to you is, aside from what has been made a matter——

Mr. ROONEY. We did——

Senator SPECTER [continuing]. Excuse me, let me finish my question—aside from what has been made a matter of public record by Norfolk Southern, which I do not care a lot about right now, I want to know what the Department of Transportation did. That is my question to you. Norfolk Southern has a certain bias in this transaction. The Department of Transportation presumably does not. What did the Department of Transportation do, according to the requirements of 1186(a)(2) of CFR, concerning the detailed determination of the effect of the proposed transaction upon employees by class and craft?

Mr. ROONEY. Senator, we asked for and examined the aggregate figures. We were concerned to see that the employment effects of the merger in an overall sense were on a basis that would allow them to be absorbed by the attrition rates of the combined companies, and we went forward on that theory.

Senator SPECTER. You examined the aggregate figures as provided to you by Norfolk Southern?

Mr. ROONEY. Yes, sir, they provided those figures.

Senator SPECTER. But no independent analysis, or determination or check was performed by the Department of Transportation?

Mr. ROONEY. The figures are part and parcel, Senator, of NS' plans for the amalgamation of the two railroads, and that would be an appropriate source for the figures.

Senator SPECTER. But that was your only source, what Norfolk Southern gave you?

Mr. ROONEY. Well, let me say this, too, Senator. As a backdrop for this entire thing, they have been negotiating with the RLEA, who have been most interested in these kinds of situations——

Senator SPECTER. Negotiating with whom?

Mr. ROONEY. The Railway Labor Executives Association.

Senator SPECTER. Do they know something about this factually, in addition to what Norfolk Southern provided?

Mr. ROONEY. I would expect they have inquired of their own member organizations——

Senator SPECTER. Have you asked them that?

Mr. ROONEY. I have not personally asked them.

Senator SPECTER. Has anybody asked them that on the part of the Department of Transportation?

Mr. ROONEY. Whether or not the RLEA has examined those figures?

Senator SPECTER. You said you would expect that they would have some independent factual basis, and I am asking you what your expectation is based on.

Mr. ROONEY. The fact, Senator, that the P&LE has within its membership ranks the ability to determine—from local stewards on up what the effects might be on the people actually working on the property.

Senator SPECTER. Well, they had the ability to, but did they?

Mr. ROONEY. I do not know that for a fact, Senator.

Senator SPECTER. OK. So what you really know about is what Norfolk Southern provided you with respect to employees by class and craft?

Mr. ROONEY. That is correct, Senator.

Senator SPECTER. Did you make any independent determination of the requirements of 1180.6(a) (8) and (9), concerning the environmental impacts, or the impacts on energy consumption?

Mr. ROONEY. No, Senator, we have not.

Senator SPECTER. How about the provisions of 1180.6(b) (l) and (2), about the evaluation of the 10(k)s and S-14's filed with the SEC by both Norfolk Southern and Conrail?

Mr. ROONEY. Senator, we have not.

Senator SPECTER. How about 1180.6(b) (3) and (4), concerning the R-1 annual reports of Norfolk Southern and Conrail, for whatever help that would be?

Mr. ROONEY. Senator, we received them. We have a complete financial data base, and we do analysis on all of the major railroad companies.

Senator SPECTER. Well, you see, the thing which concerns me, Mr. Rooney, is that when Mr. McGrath was here last week, he testified, when we pressed him for details on what the Department of Justice has done, that a further study would be redundant, because the Department of Transportation has already performed an enormously extensive review of the Norfolk Southern/Conrail consolidation. Now we come down to the specifics as to the standards for merger and consolidation, and you throw the ball right back to the Department of Justice.

Speaking only for myself, which is all I can do, and I do not intend to push this matter any further with you at the moment, I think it is plain that the Department of Transportation has not gone into these items as you have stated for the record. This acquisition/merger has not been due processed to death—it has not been processed at all.

I would be pleased to give you a chance to respond to that.

Mr. ROONEY. Senator, we have studied the matter. I used the word "preliminarily"; I used it advisedly. We have studied it in some depth from the point of view of economics and finances, of impacts upon employment. We have run diversion analyses to see what the impacts on other carriers would be, and so on—yes.

What we did was to conclude, to bring that analysis to a point where we could conclude that the Norfolk Southern could be a viable bidder for this property. But as to the competitive implications of this merger, I would stand on my remarks. We have delivered that study over to the Department of Justice in compliance with the 408(c) of this NERSA Act, which does suggest that there will be due process. It suggests that it will be taking place in the executive branch and the legislative branch, and that after due deliberation, Congress will act.

Senator SPECTER. Did you hear Mr. McGrath's testimony that analysis by Justice would be redundant because of the enormously extensive analysis already conducted by the Department of Transportation? How does that square with your statement that it is only preliminary, with all the limitations which that states, and all the open questions which that states, and then you pass it right back to the Department of Justice?

Mr. ROONEY. On matters concerning competition, Senator. I think we were referring to competition.

Senator SPECTER. There is a lot more besides competition.

Mr. Chairman, I yield back the balance of my time.

The CHAIRMAN. Thank you, Senator.

The distinguished Senator from Ohio.

Senator METZENBAUM. I do not want to go over the same ground, but I want to point out that in your fact sheet, you point out that the built-in loss rule will preclude Norfolk Southern from transferring Conrail's tax writeoffs to offset Norfolk income—that is, the $3 billion figure.

And I gather that may or may not still be your understanding of the Tax Code. The fact is that the Norfolk Southern lawyers have told us the contrary.

But let us assume that the fact sheet assertion is wrong, and that the Norfolk Southern tax lawyers are right, and that the tax benefits can be transferred. And let us assume you satisfy yourself that that may be the result.

Would the Department of Transportation want to revisit the issue of price, or in some way restrict Norfolk Southern's use of Conrail's writeoffs in order to end up with the result that you have publicly stated is the fact? You said they cannot be used; they say they can; Treasury seems to think they might be able to, but they are not certain. And I am asking you whether you would be willing to go back to Norfolk Southern and get them to agree to a modification that they will not be used.

Mr. ROONEY. Senator, I think you made that point the other day directly to the Norfolk Southern people, and they did not seem overwhelmed by the idea, to use your word. But I think they certainly received the intent of your comment.

Let me say that Norfolk Southern's management apparently stated an opinion, that they might be able to pass this de minimus test by some means of grossing up the value that NS would claim the purchase was worth.

Let me say also that the IRS would vigorously contend that this competitive bidding process had yielded a value very considerably less, and the two would negotiate. We have been careful not to abridge in any way the rights of the IRS to effectuate the Tax Code in this matter.

The final point would be that, should they be able to prevail, as you said that we should inquire, then you would have to look at when these tax deductions would inure to the benefit of Norfolk Southern——

Senator METZENBAUM. The Chairman has restricted me on time. I really did not ask you for all of that. I asked you would you be willing to go back and try to renegotiate. You told me that they said they would not like to; they made a bargain. I am saying to you that they are not stupid; they know that this is going to be one of the major factors in getting this legislation through, and maybe they would be willing to.

I am asking are you willing to go back and try to get them to change and give you a specific representation on the point.

Mr. ROONEY. Senator, I am not prepared to do that. You have certainly made your point. I suggest you might want to make that point directly.

Senator METZENBAUM. To whom?

Mr. ROONEY. To the Norfolk Southern people, by virtue of some kind of communication.

Senator METZENBAUM. Mr. Rooney, you don't seem to understand me. They are not on my side. You are supposed to be on my side. I am the Government, I am part of the Government. You are part of the Government. Why are you asking me to go to Norfolk Southern and try to get it agreed to? The question is are you willing to go to them.

Mr. ROONEY. Senator, I will inquire about that matter and come back to you with an answer. I am afraid I am a little far down the totem pole to make that kind of a decision.

Senator METZENBAUM. That is a fair statement.

Your factsheet on the tax aspects of the Conrail sale claims that Congress mandated that Conrail be sold as a stock acquisition for tax purposes. It said it was mandated by Congress.

Where is that located in the statute? We cannot find it.

Mr. ROONEY. Senator, the NERSA construction is such that if Conrail passed a series of profitability tests which were conducted in 1983, then the Secretary was to take every measure possible to sell the railroad as an entity, as a going enterprise.

I cannot cite you—there are combinations of sections—counsel proposes he can.

Mr. LINDSAY. If I may, Senator.

Senator METZENBAUM. Go ahead.

Mr. LINDSAY. NERSA now shows up—or at least, the relevant portion of NERSA, title 4, shows up as title 4 of the 3-R Act now. The portion that you are looking for, I believe, is basically section 401. Section 401(a) is entitled, "Plan for Sale of Common Stock." It says, if I can read it briefly, "As soon as practicable after the effective date of the Northeast Rail Service Act of 1981, the Secretary shall engage the services of an investment banking firm or similar financial institution, which firm or institution shall arrange for the sale of of the interest of the United States in the common stock of the corporation under this section." And further——

Senator METZENBAUM. I am aware of that, but you have not answered my question. You know as a matter of law that you may have a stock sale that will be treated as an asset sale for tax purposes or as a stock sale for tax purposes. And you have represented that it had to be sold as a stock acquisition for tax purposes. If you sold it as an asset sale, then it would have a $1.2 billion basis for tax purposes.

My question is not about the use of the words, "stock acquisition"; my question is you said that Conrail must be sold as a stock acquisition for tax purposes. And I am asking you where does it say it has to be sold as a stock acquisition for tax purposes?

Mr. LINDSAY. The words, "for tax purposes," do not appear in the statute. All that we are instructed to do is a stock sale. I am sorry. I misunderstood your question.

Senator METZENBAUM. All right, and it could be sold as an asset sale for tax purposes—even though it was a stock sale. It could for tax purposes be considered as an asset sale. And as a matter of fact, there is a corporate-qualified stock purchase election under section 338(g), which specifically provides for the purchaser to make that kind of an option. That could and should have been done. You represented to us to the contrary. And I am pointing out to you that for tax purposes it could be an asset transaction rather than a stock transaction.

Mr. Rooney. Senator, may I be permitted a second here to redeem myself on that point?

Senator Metzenbaum. Please.

Mr. Rooney. Senator, you point out quite correctly that the purchaser has the election. He may make a section 338 election. He may also carry over the basis, in the case where the basis is higher, and presumably, in this case, he would indeed carry it over under normal circumstances—again, the usual application of the tax law.

Senator Metzenbaum. But you gave him the opportunity to use the $3 billion figure instead of the $1.2 billion figure.

Mr. Rooney. Senator, that is the other side of exactly the same question you just put to me——

Senator Metzenbaum. I just wanted to make it clear.

Mr. Rooney [continuing]. When I referenced the totem pole and said I would come back to you on it.

[The following was subsequently supplied for the record:]

Question. The Department of Transportation's fact sheet states that the built-in loss rule precludes NS from transferring Conrail's tax writeoffs to offset NS' income. Norfolk Southern lawyers contend this is not true. Would the Department be willing to go back to renegotiate with Norfolk Southern and get them to accept a modification to the Memorandum of Intent to prevent them from using these write-offs.

Answer. In testimony before the House Energy and Commerce Committee on Transportation, Secretary Dole said she would support an amendment which would limit NS' ability to utilize deductions generated by Conrail.

The Chairman. Excuse me. Mr. Ross is here from the Treasury Department, Mr. Rooney. Did you want him to come up and join you in answering some of these tax questions?

Mr. Rooney. I would appreciate the help, if the Chair would permit, if we are going to do this as a panel discussion.

The Chairman. Would you like him to join him now?

Senator Metzenbaum. That is fine. As long as it does not impact upon my time, I do not have any objection. But I guess, Mr. Chairman, in all fairness, there are no other witnesses here, so I suppose I can carry on until I finish.

The Chairman. I thought if you had questions, you could have Mr. Ross come up.

Senator Metzenbaum. That would be fine. I would be happy to have him come forward.

The Chairman. Mr. Ross, would you come forward and answer these tax questions that have been propounded, please? We had planned to call you, anyhow, as the last witness.

Senator Metzenbaum. Mr. Ross, would you like to add anything to the dialog that has just taken place between Mr. Rooney and myself?

Mr. Ross. Well, Senator Metzenbaum, I would simply affirm what Mr. Rooney has said, that the current law gives an election to the purchaser as to whether or not to treat a stock acquisition as in effect an asset acquisition. That election is provided under section 338 of the code, as you cited. Again, it is an election with the purchaser.

If you are asking did we insist that the purchaser in this case make a section 338 election, we did not. Again, the intent generally with respect to this transaction as Mr. Rooney has described it was for ordinary tax consequences to apply and not to carve out special treatment of Norfolk Southern. The only case in which that is not true is with respect to certain tax attributes which Norfolk Southern has been denied and which would, under ordinarily applicable tax principles, have carried over to Norfolk.

Senator METZENBAUM. Well, we have to put this in the proper context. I was asking the question in relation to the fact that the DOT had publicly stated that we mandated that Conrail be sold as a stock acquisition for tax purposes, and the fact is, and that has already been agreed to, we did not mandate that.

The other point I would make is the DOT could have provided in the agreement that the election would not be available to Norfolk Southern, and if that were the case, then it would have had to be treated as an asset sale, and there would have been no opportunity at all to use the $3 billion figure.

Mr. ROSS. That really is not accurate, if I can continue. The election is to treat a stock acquisition as an asset acquisition. If the agreement had provided that no such election would have been available, the transaction would be treated——

Senator METZENBAUM. Wait a minute. Say that again.

Mr. ROSS. The election provided in the Code is to treat a stock acquisition as an asset acquisition.

Senator METZENBAUM. OK.

Mr. ROSS. Absent that election, the consequences would be as they have been set out in the Norfolk case. So you would had to provide not that the election was not available, but that Norfolk would have to make the election against their interest.

Senator METZENBAUM. They could have done that.

Mr. ROSS. It could have been done, yes.

Senator METZENBAUM. Now, according to the March 6th DOT fact sheet, the forgiveness of Conrail's debt——

The CHAIRMAN. Senator, your time is up, but there are no other Senators here, so just continue.

Senator METZENBAUM [continuing]. Thank you, sir; I will not be long—the forgiveness of Conrail's debt "was mandated by Congress in 1981."

Would you please cite the section of law that mandated the complete cancellation of the $3.2 billion debt?

Mr. ROONEY. Senator, the section is 402(a), described as "Limitation." I am afraid I cannot give you the cross-reference——

Senator METZENBAUM. I have 402(a). I do not read that it says that.

Mr. ROONEY [reading]:

> Prior to any sale of the common stock of the corporation under section 401, the interest of the United States in any debt or preferred stock of the corporation held by the United States, or any agent or instrumentality, et cetera, shall be limited to any interest which attaches to such debt or preferred stock in the event of bankruptcy, et cetera.

The notion of limitation——

Senator METZENBAUM. I understand, but that does not say that at all. It says what occurs in the event of bankruptcy. We do not have bankruptcy here. Excuse me. We do have substantial sale. But that does not say that the debt has to be canceled.

As a matter of fact, the first time you read about the debt being canceled is in this legislation before us, which is section 106 of the bill, that directs NERSA to permit cancellation of the debt. That is the first time we hear of that. There is nothing in this language that in any way comes close to the language that is in the present law. And I would just like to point out to you that if you read that as mandating the cancellation of the debt that Congress required it, then I say to you that I think you need a new lawyer, because I do not think he is reading the langauge right. It does not say that.

Mr. ROONEY. Senator, the missing aspect here is the contingent interest notes that would take effect in the event of bankruptcy and give us an overlay of residual interest. The problem with these notes is that they really effectively prevent a sale. Let us take, for example, the public offering scenario. No one would permit such a public offering if the equity investors had no residual interest in the company, or if $3.2 billion worth of overlaying liabilities would suddenly come into play if the company got into extremis. The notion was simply to remove a patent obstacle to marketability.

Senator METZENBAUM. Well, I can understand your doing it, but I cannot understand your saying that we ordered you to do it. I think that is the point I am making.

Mr. ROONEY. Yes, Senator, your point is well taken about the wording.

Senator METZENBAUM. Now let me ask you this. I am worried about the pension plan and the possibility of a reversion. Can that occur under the agreement?

Mr. ROONEY. Senator, the agreement says that no reversion shall take place.

Senator METZENBAUM. Right. Now, can anything happen to that? Is that really locked in solidly? Is there any possibility of the company being able to get that money?

Mr. ROONEY. Senator, I am going to look that up for a second. I think that there are some provisions in there that allow them to merge. I do not have that section in front of me.

Senator METZENBAUM. Let me ask you, Senator Specter has been concerned about whether you are going to continue to operate from the Philadelphia headquarters. Can he go to sleep at night and tell his constituents that there is an absolute guarantee that will happen?

Mr. ROONEY. Senator, we have received a written communication—I believe that Senator Specter has a copy of it—that declares point-blank that Norfolk Southern's aquisition of Conrail would only impact Philadelphia area employment to—I think the phrase used is "fewer than 25 people." We certainly view that as a commitment.

Senator SPECTER. For how long?

Mr. ROONEY. I believe the language that they use, Senator, to be absolutely precise here, is as a consequence of the merger.

Senator SPECTER. Five years?

Mr. ROONEY. The chief executive officer of the company has also stated, I would add, that NS does not contemplate any measures to move that workforce anywhere else and has not done so with respect to its other headquarters locations of its other railroads.

Senator SPECTER. If the Senator would yield for an answer on the question of sleeping soundly, it is "No."

Senator METZENBAUM. The answer is "No," "that they cannot sleep—well, he has no right to sleep soundly. [Laughter.]

For this, as well as many other reasons. But the fact is that page 24, paragraph 16, opens the door wide to any one of a host of possibilities, including termination of the pension plan, seeking a reversion, the requirement that Conrail continues to operate from the Philadelphia headquarters, the requirement that Conrail continue its affirmative action program, and a host of other positive warranties, because——

The CHAIRMAN. Senator, let me ask you a question. Would you consider pension plans to be on the merits, or concerning antitrust? We only have jurisdiction in regard to the antitrust, now. However, I have allowed a wide flexibility here. But it is not the business of this committee to go into every facet here. It is our business to determine the antitrust question.

Senator METZENBAUM. I appreciate what the chairman is saying, and I am going to be finished in just 1 minute. I want to point out to you that the Secretary of Transportation is given the right under this aqreement to "waive any covenant, agreement, or obligation contained in the definitive agreement."

Now, if that is the case, we do not know who will be the Secretary of Transportation next week, next month, 2 years from now, 5 years from now. So all of these affirmative and positive representations and covenants can be waived.

And I would point out to you, Mr. Rooney, that that has to cause everybody who is affected by this agreement to feel very edgy, because you and I both know that many people in Government have seen fit to waive specific provisions, and there is no appeal, once they make the waiver. Doesn't that concern you at all? Wouldn't you think that we ought to get that provision changed in some way so there is more protection, or at least, not make it applicable to all of the covenants, agreements and obligations contained in the definitive agreement?

Mr. ROONEY. Senator, the language on page 16, subparagraph 16(c)(ii) also circumscribes that right of waiver such that the Secretary must, prior to making such a waiver, determine that it will not impair the effectiveness of the railroad, et cetera, et cetera.

Senator METZENBAUM. Well, that would not impair the effectiveness of the railroad. You pick up $250 million by the pension, and you go someplace else, you can go to Paduka or somewhere, and maybe operate cheaper than you can in Philadelphia. That would not affect this.

Mr. ROONEY. It certainly has a bearing in an implicit way on rail service, in that certainly, employee interests would be affected, and also, it has an effect upon financial——

The CHAIRMAN. The Senator's time has expired.

The distinguished Senator from Utah.

Senator HATCH. I will pass for now.

The CHAIRMAN. The distinguished Senator from Pennsylvania.

Senator SPECTER. I have no further questions, Mr. Chairman.

The CHAIRMAN. The distinguished Senator from Ohio.

Senator METZENBAUM. I have no further questions.

The CHAIRMAN. Mr. Ross, you have described the tax treatment of Conrail assets—I do not believe you have made your statement yet, and you have a right to put your statement in the record.

Do you have a written statement?

Mr. ROSS. Yes, I do, Mr. Chairman.

The CHAIRMAN. Without objection, that will be placed in the record. Could you take 5 minutes and give us the thrust of it?

STATEMENT OF HON. DENNIS E. ROSS, ACTING DEPUTY TAX LEGISLATIVE COUNSEL, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. ROSS. Yes; I will try and be brief, Mr. Chairman.

I am pleased to have the opportunity to present the views of the Treasury Department on the Federal income tax policy issues raised by the proposed sale of the Federal Government's interest in Conrail to Norfolk Southern. I have attached to my statement a letter that we have sent to Senator Danforth, who is chairman of the Senate Commerce Committee's Subcommittee on Surface Transportation. That letter contains a more detailed analysis of the tax policy issues. Accordingly, I will try to keep my oral statement brief.

As you know, Mr. Chairman, Congress in 1981 directed the Secretary of Transportation to submit a plan for the sale of the Federal Government's interest in Conrail.

The Treasury Department has consulted closely with the Department of Transportation with regard to the tax policy aspects of the sale of Conrail, and in particular with regard to the tax policy aspects of the proposed sale of Conrail to Norfolk Southern.

Our advice to the Transportation Department has been guided by two basic policy objectives. First, that the sale of Conrail should not provide the purchaser with Federal income tax benefits that would not be available to the parties in an analogous private transaction; and second, that the Internal Revenue Service, in its role as administrator of the Federal income tax laws, should not be prevented by the sales agreement or by the enabling legislation from treating Conrail in the same manner as it would any other taxpayer.

Let me turn first to the question of Conrail's tax attributes and their treatment in the proposed transaction.

The plan requested by Congress was for the sale of Conrail as a single entity. Under current law, there are significant differences in the Federal income tax treatment of the sale of stock of a corporation, as opposed to the sale of the corporation's assets. In general, a purchaser of the stock of a corporation receives a tax basis in the stock purchased equal to the consideration paid for the stock. Other than this change in tax basis for the purchased stock, the sale of a corporation's stock generally does not trigger tax consequences either to the purchaser or to the corporation whose stock is sold. Accordingly, the existing tax attributes of the acquired corporation generally remain intact in the hands of the persons who own the corporation, even though they are different persons than the prior owners.

Given the treatment of a stock purchase transaction under current law, if the proposed sale of Conrail had occurred between private parties, the tax attributes of Conrail, such as its net operating loss carryforwards, its investment tax credit carryforwards, and its asset tax basis, including its so-called frozen asset base, would remain intact following the sale.

The tax consequences of the proposed sale of Conrail to Norfolk Southern would depart from this private transaction model in that certain of Conrail's tax attributes would not survive the sale transaction. Thus, pursuant to a closing agreement which is called for in the memorandum of intent, between Conrail and the Internal Revenue Service, Conrail's net operating loss carryforwards, investment tax credit carryforwards, and other tax carryforwards would, with certain exceptions, not be available for carryforward to taxable years beginning after the sale of Conrail.

At the same time, other Conrail tax attributes, in particular, Conrail's asset basis, would, as would be the case in a private party transaction, carry over to the taxable years of Conrail beginning after the closing.

We believe the different treatment of Conrail's tax carryforwards on the one hand, and its asset basis on the other, is appropriate for a number of reasons. First, Conrail's existing carryforwards arose during the period of the Federal Government's ownership of Conrail, and are for the most part attributable to moneys invested in Conrail by the Federal Government. The same is not true of Conrail's asset basis. Though the assets of Conrail have changed substantially since the time of its formation in 1976, data provided to us by the Department of Transportation indicates that the aggregate tax basis of its assets is roughly equal now to what it was in 1976. Thus, the proposed sale of Conrail to Norfolk Southern would return Conrail to the private sector with substantially the same asset basis as at the time the Federal Government acquired Conrail.

Now, we of course recognize that the purchase price of a sale transaction will reflect the extent to which advantageous tax attributes carry over in the transaction. Where the Federal Government is the seller in a transaction, however, any gain in purchase price from a carryover of favorable tax attributes must be weighed against future revenue losses attributable to the use of those tax attributes. Now, this weighing is more difficult to the extent that the purchaser's ability to use the attributes is uncertain. In this respect, the value of Conrail's carryforwards is inherently more speculative than the value of its asset basis. Since the carryforwards would be of future value only to the extent that annual depreciation deductions generated by Conrail's asset basis had already been fully utilized, it thus seemed to us reasonable for the Federal Government to require termination of Conrail's carryforwards, rather than to try and speculate as to their value, while, in accord with the model of a private party transaction, permitting Conrail to return to the private sector with its asset basis intact.

It should also be noted that the treatment of Conrail's tax attributes in the proposed sale to Norfolk Southern is similar to what was approved by Congress at the time of Conrail's formation. Thus, legislation adopted in connection with Conrail's formation, which is now reflected in section 374 of the Internal Revenue code, provided that the net operating loss carryforwards of Conrail's predecessors would not carry over to Conrail, whereas Conrail would inherit its predecessor's asset basis.

If I could turn just briefly to the effect of the proposed sale on the administration of the tax laws, the IRS, as you know, is charged with such administration, and in order to carry out its responsibilities, it cannot show special treatment for any taxpayer. We, in short, believe that the Department of Transportation's plan for the sale of Conrail is consistent with the IRS special administrative responsibilities.

The CHAIRMAN. I have a few questions here, but to save time, I will let you answer for the record.

[Prepared statement and responses to questions follow:]

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STATEMENT OF
DENNIS E. ROSS
ACTING DEPUTY TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON JUDICIARY
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to present the views of the Treasury Department on the Federal income tax policy issues raised by the proposed sale by the Federal government of its interest in the Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk" or "Norfolk Southern"). I have attached to my statement a letter that we have sent to Senator Danforth, Chairman of the Senate Commerce Committee's Subcommittee on Surface Transportation, containing a more detailed analysis of these tax policy issues.

Section 401 of the Regional Rail Reorganization Act of 1973 enacted by the Northeast Rail Service Act of 1981 directed the Secretary of Transportation to submit to the Congress a plan for the sale of the Federal government's interest in approximately 85 percent of Conrail's common stock to (1) ensure continued rail service; (2) promote competitive bidding for the stock; and (3) maximize the government's return on its investment in Conrail. After careful review of a number of purchase proposals, the Secretary of Transportation has recommended sale of Conrail to Norfolk Southern.

The Treasury Department has consulted closely with the Department of Transportation with regard to the tax policy aspects of the sale of Conrail. Our advice to the Transportation

Department has been guided by two basic policy objectives: (1) that the sale of Conrail should not provide the purchaser with Federal income tax benefits that would not be available in an analogous transaction between private parties; and (2) that the Internal Revenue Service ("IRS"), in its role as administrator of the Federal income tax laws, should not be prevented by the sales agreement or enabling legislation from treating Conrail in the same manner as it would any other taxpayer.

Treatment of Conrail's Tax Benefits

Under current law there are significant differences in the Federal income tax treatment of a sale of stock and a sale of the assets of a corporation. In general, a purchaser of the stock of a corporation receives a tax basis in the stock purchased equal in amount to the consideration paid for such stock. Other than this change in tax basis for the stock purchased, the sale of stock of a corporation generally does not trigger tax consequences either to the purchaser or to the corporation whose stock is sold. Accordingly, the existing tax attributes of the acquired corporation generally remain intact even though the corporation is owned by different persons.

Given the treatment of stock purchase transactions under current law, if the proposed sale of Conrail stock occurred between private parties the tax attributes of Conrail, such as its net operating loss carryforwards, investment tax credit carryforwards, and asset tax basis (including the so-called "frozen asset base"), would remain intact following the sale. The tax consequences of the proposed sale of Conrail to Norfolk Southern would depart from this private transaction model in that certain of Conrail's tax attributes would not survive the sale transaction. Thus, pursuant to a closing agreement to be entered into between Conrail and the IRS, Conrail's net operating loss, investment tax credit and other carryforwards would, with certain exceptions, not be available for carryforward to taxable years beginning after the date of sale (hereinafter, the "Closing").* At the same time, other Conrail tax attributes, in particular, Conrail's asset basis, would, as in a private party transaction, carry over to taxable years after the Closing.

We believe the different treatment of Conrail's tax carryforwards on the one hand and its asset basis on the other is appropriate for a number of reasons. Conrail's existing carryforwards arose during the period of the Federal government's ownership and are for the most part attributable to monies invested in Conrail by the Federal government. The same is not true of Conrail's asset basis. Although the assets held by Conrail have changed substantially since its formation in 1976, data provided to us by the Department of Transportation indicates that the aggregate tax basis of its assets (as of December 31, 1983) is roughly equal to what it was at that time. Thus, the proposed transaction would return Conrail to the private sector with substantially the same asset basis as at the time the Federal government acquired it.*

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* The closing agreement would also provide that Conrail's taxable year would terminate as of the Closing.

We, of course, recognize that the purchase price in a sale transaction will reflect the extent to which advantageous tax attributes carry over in an acquisition. Where the Federal government is the seller, however, any gain in purchase price from a carry over of favorable tax attributes must be weighed against future revenue losses attributable to the purchaser's utilization of the tax attributes. This weighing is more difficult to the extent the purchaser's ability to use the attributes is uncertain. In this respect, the value of Conrail's carryforwards is inherently more speculative than the value of its asset basis, since the carryforwards would be of future value only to the extent that annual depreciation deductions generated by Conrail's asset basis had already been fully utilized. It would thus appear reasonable for the Federal government to require the termination of Conrail's carryforwards rather than speculate as to their value, while, in accord with the model of a private transaction, permitting Conrail to return to the private sector with its asset basis intact.

It should also be noted that the treatment of Conrail's tax attributes in the proposed sale is similar to what was approved by Congress at the time of Conrail's formation. Thus, legislation adopted in connection with Conrail's formation, now reflected in section 374(c) of the Internal Revenue Code (the "Code"), provided that the net operating loss carryforwards of Conrail's predecessors would not carry over to Conrail whereas Conrail would inherit its predecessors' asset basis. The tax consequences of the proposed sale of Conrail to Norfolk Southern would generally conform to that legislative precedent.

Finally, the carry over of Conrail's asset basis should not cause a reduction in Federal income tax revenues collected from Conrail. Although Conrail is a taxable entity, it has not previously paid Federal income tax, nor would it in the foreseeable future given its substantial carryforwards and the high basis in its assets. Because Conrail's carryforwards would not survive the proposed sale to Norfolk Southern, the transaction would, if anything, accelerate the point at which Conrail would become a taxpaying corporation.

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* If the effects of inflation are accounted for, Conrail's current asset basis is, of course, much less than at the time of its formation. Moreover, since the value of Conrail's assets today likely exceeds their value at the time of Conrail's formation, the built-in loss in Conrail's assets (i.e., the excess of their basis over value) is likely smaller today than it was at Conrail's formation.

Separation of Government Roles

The IRS is charged with administration and enforcement of the Federal income tax laws. In order to effectively carry out this mission, no preference or special rules can be adopted for any taxpayer.

We believe the Department of Transportation's plan for the sale of Conrail is consistent with the IRS' special responsibilities as administrator of the Federal income tax laws. Most importantly, the plan does not restrict the IRS from auditing or assessing tax liabilities against Norfolk Southern or Conrail after the sale. To the extent Norfolk Southern would be protected in the proposed transaction against possible tax liabilities of Conrail or of Norfolk, such protection would be provided in the form of a warranty, rather than covenant by the IRS, in order that the IRS be able to fulfill its mission of evenly administering and enforcing the Federal income tax laws. Certain legislation, which is included in the proposal submitted by the Department of Transportation, would be necessary to implement a procedure for Norfolk Southern to enforce such tax warranties against the Federal government.

Special Legislation for Conrail's Employee Stock Ownership Plan

Certain legislation is also required to qualify for tax purposes Conrail's employee stock ownership plan that was created by earlier legislation. This legislation, which is included in the proposal submitted by the Department of Transportation, is necessary because of the possibly unique form of Norfolk Southern's arrangements with Conrail's labor unions and employees and the unusual structure of Conrail's employee stock ownership plan.

* * *

This concludes my prepared remarks. I would be happy to respond to your questions.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

March 27, 1985

Dear Mr. Chairman:

This is in response to your request for our views of the Federal income tax policy issues raised by the proposed sale of the Federal government's interest in the Consolidated Rail Corporation ("Conrail") to Norfolk Southern Corporation ("Norfolk"). In preparing this response, we have not comprehensively examined all potential Federal income tax consequences of the proposed sale, but have limited our analysis to certain issues of tax policy raised by the Federal government's ownership of Conrail and the form of the proposed transaction. In addition, our analysis has assumed that the details of the proposed transaction are accurately reflected in the Memorandum of Intent signed February 8, 1985 by Norfolk and the Department of Transportation, and in H.R. 1449 and S. 638, the pending legislation that would authorize and establish terms for the sale of Conrail.

We have previously consulted with the Department of Transportation with regard to its Congressionally mandated plan for the return of Conrail to the private sector. We thus have advised the Department of Transportation as to Federal income tax aspects of the sale of Conrail and have reviewed the tax implications of the bids for Conrail and of draft language for the Memorandum of Intent and enabling legislation. Our prior advice and the conclusions set forth in this response have been guided by two basic policy objectives: 1) that the sale of Conrail should not provide the purchaser with Federal income tax benefits that would not be available in an analogous transaction between private parties; and 2) that the Internal Revenue Service (the "IRS"), in its role as administrator of the Federal income tax laws, should not be prevented by the sales agreement or enabling legislation from treating Conrail in the same manner as it would any other taxpayer. Based on our analysis of the Memorandum of Intent and the enabling legislation, we believe that the proposed sale is basically consistent with these policy objectives.

Background

Section 401 of the Regional Rail Reorganization Act of 1973 enacted by the Northeast Rail Service Act of 1981 directed the Department of Transportation to devise a plan for returning Conrail to the private sector, preferably by sale of common stock rather than by a sale of its assets. Under current law there are significant differences in the Federal income tax treatment of a sale of stock and a sale of the assets of a corporation. In general, a purchaser of the stock of a corporation receives a tax basis in the stock purchased equal in amount to the consideration paid for such stock. Other than this change in tax basis for the stock purchased, the sale of stock of a corporation generally does not trigger tax consequences either to the purchaser or to the corporation whose stock is sold. Accordingly, the existing tax attributes of the acquired corporation generally remain intact even though the corporation is owned by different persons.

Carry Over of Tax Attributes

Given the treatment of stock purchase transactions under current law, if the proposed sale of Conrail stock occurred between private parties the tax attributes of Conrail, such as its net operating loss carryforwards, investment tax credit carryforwards, and asset tax basis (including the so-called "frozen asset base"), would remain intact following the sale. The tax consequences of the proposed sale of Conrail to Norfolk would depart from this private transaction model in that certain of Conrail's tax attributes would not survive the sale transaction. Thus, pursuant to a closing agreement to be entered into between Conrail and the IRS, Conrail's net operating loss, investment tax credit and other carryforwards would, with certain exceptions, not be available for carryforward to taxable years beginning after the date of sale (hereinafter, the "Closing").* At the same time, other Conrail tax attributes, in particular, Conrail's asset basis, would, as in a private party transaction, carry over to taxable years after the Closing.

We believe the different treatment of Conrail's tax carryforwards on the one hand and its asset basis on the other is appropriate for a number of reasons. Conrail's existing carryforwards arose during the period of the Federal government's ownership and are for the most part attributable to monies invested in Conrail by the Federal government. The same is not true of Conrail's asset basis. Although the assets held by Conrail have changed substantially since its formation in 1976, data provided to us by the Department of Transportation indicates that the aggregate tax basis of its assets (as of December 31, 1983) is roughly equal to what it was at that time. Thus, the proposed transaction would return Conrail to the private sector with substantially the same asset basis as at the time the Federal government acquired it.**

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* The closing agreement would also provide that Conrail's taxable year would terminate as of the Closing.

** If the effects of inflation are accounted for, Conrail's current asset basis is, of course, much less than at the time of its formation. Moreover, since the value of Conrail's assets today likely exceeds their value at the time of Conrail's formation, the built-in loss in its assets (i.e., the excess of their basis over value) is likely smaller today than it was at Conrail's formation.

We, of course, recognize that the purchase price in a sale transaction will reflect the extent to which advantageous tax attributes carry over in an acquisition. Where the Federal government is the seller, however, any gain in purchase price from a carry over of favorable tax attributes must be weighed against future revenue losses attributable to the purchaser's utilization of the tax attributes. This weighing is more difficult to the extent the purchaser's ability to use the attributes is uncertain. In this respect, the value of Conrail's carryforwards is inherently more speculative than the value of its asset basis, since the carryforwards would be of future value only to the extent that annual depreciation deductions generated by Conrail's asset basis had already been fully utilized. It would thus appear reasonable for the Federal government to require the termination of Conrail's carryforwards rather than speculate as to their value, while, in accord with the model of a private transaction, permitting Conrail to return to the private sector with its asset basis intact.

It should also be noted that the treatment of Conrail's tax attributes in the proposed sale is similar to what was approved by Congress at the time of Conrail's formation. Thus, legislation adopted in connection with Conrail's formation, now reflected in section 374(c) of the Internal Revenue Code (the "Code"), provided that the net operating loss carryforwards of Conrail's predecessors would not carry over to Conrail whereas Conrail would inherit its predecessors' asset basis. The tax consequences of the proposed sale of Conrail would generally conform to that legislative precedent.

Finally, the carry over of Conrail's asset basis should not cause a reduction in Federal income tax revenues collected from Conrail. Although Conrail is a taxable entity, it has not previously paid Federal income tax, nor would it in the foreseeable future given its substantial carryforwards and the high basis in its assets. Because Conrail's carryforwards would not survive the proposed sale to Norfolk, the transaction would, if anything, accelerate the point at which Conrail would become a taxpaying corporation.

Utilization of Conrail Deductions By Norfolk

The proposed sale transaction could adversely affect Federal income tax revenues if future deductions generated by Conrail's asset basis could be utilized to offset otherwise taxable income of Norfolk. As an includible member in Norfolk's consolidated return, tax losses of Conrail could currently offset taxable income of any other member in the consolidated return unless such losses were limited under the separate return limitation year

("SRLY") and the built-in deduction rules of the consolidated return regulations. These rules, in general, prevent the utilization of an acquired corporation's pre-acquisition losses (including losses attributable to assets with tax basis in excess of fair market value, so-called "built-in deductions") against income of any member of the acquiring group. It is conceivable that Norfolk would seek to avoid these restrictions through any of the following strategies: by satisfying the so-called *de minimis* exception to the SRLY and built-in deduction rules, by transferring assets to Conrail, the income from which would be absorbed by Conrail losses, or by merging Conrail into Norfolk (or an affiliated corporation) in a transaction in which Conrail's tax attributes would carry over.

The consolidated return regulations would provide an exception to the SRLY and built-in deduction rules, if, on the acquisition date, the aggregate of the adjusted tax basis of all assets of Conrail (other than cash, marketable securities, and goodwill) do not exceed the fair market value of such assets by more than 15 percent. See Treas. Reg. § 1.1502-15(a)(4)(i)(*b*). A review of Conrail's tax data, provided to us by the Department of Transportation, suggests that Conrail would not satisfy the *de minimis* exception, since its aggregate tax basis appears to exceed $3 billion, and Norfolk is paying only $1.2 billion for 85 percent of Conrail's common stock. The *de minimis* exception, however, is based on the fair market value of Conrail's assets rather than the value of Conrail's stock. Since we do not have appraisals or other direct information concerning the fair market value of Conrail's assets, it is not certain that Conrail would not satisfy the *de minimis* exception.*

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* Paragraph 12(e) of the Memorandum of Intent provides that as a condition to Norfolk buying Conrail from the Federal government, Norfolk shall have received (at the Federal government's sole election) either a ruling or a warranty that amounts paid to employees of Conrail for services rendered after Closing in order to increase their post-Closing wages to industry standard and the costs paid or incurred for certain routing concessions which are otherwise ordinary and necessary business expenses shall not be treated as built-in deductions and can be deducted when accrued or paid. Although the SRLY and built-in deduction rules apply to amounts economically accrued but not yet deducted, the above expenses do not appear to constitute built-in deductions. Because of the condition that such expenses must otherwise be ordinary and necessary business expenses, the ruling or warranty required by the above condition does not warrant the deductibility of such amounts; only that such amounts are not built-in deductions.

Norfolk's ability to avoid the SRLY and built-in deduction rules by either transferring assets to Conrail or by merging Conrail into Norfolk or an affiliate would be constrained by Norfolk's contractual obligations, by practical business considerations and by the provisions of the tax law. Paragraph 12(b)(iii) of the Memorandum of Intent appears to prohibit a merger of Conrail into Norfolk (or an affiliated corporation) for at least five years after the Closing. In addition, it is questionable whether Norfolk would transfer significant income producing assets to Conrail given that, as reflected in Paragraph 12(b) of the Memorandum of Intent, there would be significant restrictions on Norfolk's ability to withdraw assets from Conrail. With regard to tax law limitations, a transfer of significant assets to Conrail or a merger of Conrail into Norfolk (or an affiliated corporation) could subject future use of Conrail deductions to challenge under section 269 of the Code. See Treas. Reg. § 1.269-3(b)(1).

Warranty of Asset Basis

As provided in Paragraph 6(e)(ii) of the Memorandum of Intent, the Federal government would warrant to Norfolk that the asset basis reflected on Conrail's tax return for the year ending on the Closing would not be decreased as a result of an audit adjustment for a taxable year ending on or before the Closing. We believe this warranty is appropriate for a variety of reasons. Most importantly, the warranty protection extended to Norfolk is consistent with the allocation of risks that could be expected in an analogous private party transaction. Conrail has not been audited since its formation and its tax basis in many assets would have to be traced to its predecessors. As a consequence, Norfolk has no effective means of determining whether Conrail's asset basis is accurately reflected on its tax returns. In circumstances where the accuracy of the selling party's tax accounting cannot be established, it is reasonable to expect the seller to retain the risk of audit.

Consistent with the above warranty, Paragraph 6(e)(iii) and (iv) of the Memorandum of Intent require the Federal government to warrant that the adjusted tax basis of Conrail's assets would not be reduced and no gain or loss or income would be recognized by Conrail or Norfolk as a result of the sale of Conrail's stock to Norfolk, except in the event Norfolk makes, or is deemed to have made, an election under section 338 of the Code. If a section 338 election were made (or deemed made) by Norfolk in connection with its purchase of the stock of Conrail, Conrail would be treated as if it sold all of its assets to itself in a liquidating sale, and the tax basis of its assets would be adjusted to an amount based upon the amount Norfolk paid for Conrail's stock (grossed-up to reflect a purchase of 100 percent of Conrail's stock). The Memorandum of Intent further provides that, for purposes of the warranty, Norfolk would not be deemed to make a section 338 election as a result of any asset acquisition provided that Norfolk (and its affiliates) elect either to treat such assets acquired in accordance with regulations promulgated under section 338 or elect under conditions to be agreed upon that the basis of such assets would not exceed the transferor's basis in the assets immediately before the acquisition. This warranty was provided because, as of the date the Memorandum of Intent was signed, the regulations providing for a carryover basis to avoid a deemed election under section 338, contemplated by Congress in the Tax Reform Act of 1984, had not been issued.

It should be noted that the warranty protection that Norfolk receives is not a guarantee that the IRS will not audit Conrail for pre-Closing years or that if it does so that it will not be entitled to require a reduction in Conrail's asset basis. In the event of an IRS audit and resultant reduction in basis, the warranty procedure contemplated in the Memorandum of Intent and enabling legislation entitles Conrail to sue in Federal court and to obtain a judgment which could be applied to offset any increase in tax liability attributable to the basis reduction. Although this procedure leaves Conrail economically protected from the risk of audit, it does not otherwise impair the IRS' ability to conduct an audit of Conrail. Retention of the IRS' audit authority with respect to Conrail's pre-Closing years could be significant to the extent substantive tax issues relating to those years have relevance to issues arising in other tax years of Conrail or to the administration of the Federal income tax system generally.

Change in Methods of Depreciation

The potential value of any built-in loss in Conrail's assets also depends on the period of time over which those assets would be depreciated. The warranty as to asset basis provided in Paragraph 6(e)(ii) of the Memorandum of Intent contains a condition that the depreciation of such assets should be determined without extraordinary departures from the methods of prior years. In general, since a depreciation method is considered a method of accounting, a taxpayer cannot change its method of depreciation with respect to a particular asset without first obtaining permission from the Commissioner of the IRS.* In this regard, Conrail and Norfolk would be treated the same as any other taxpayer if, after the sale of Conrail, a change in depreciation method were requested.

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* Section 203(c) of the Economic Recovery Tax Act of 1981 permitted taxpayers to change their method of depreciating railroad track without having such change treated as a change in method of accounting. It does not appear that this provision applies to a change in the method of depreciating railroad track initiated after 1981. Thus, Conrail should not be able to change its present method of depreciating its "frozen asset base" without securing the prior approval of the IRS.

Carry Over of Earnings & Profits

At present, Conrail may have a deficit earnings and profit account reflecting its substantial net losses over the period of its operation.* The Memorandum of Intent does not directly state whether the earnings and profits history of Conrail would carry over to post-Closing taxable years. Since earnings and profits ordinarily would carry over in a stock acquisition, the failure to state a contrary result suggests that Conrail's earnings and profits account would survive the transaction. Since earnings and profits are a measure of a corporation's income or loss, it would seem that Conrail's earnings and profits should be treated consistently with Conrail's net operating losses, and thus should not carry over to post-Closing years. We thus believe that a definitive sale agreement should clarify the treatment of Conrail's earnings and profits by providing that they not carry over in the sale transaction.

The value to Norfolk of a carryover of Conrail's earnings and profits is uncertain. Earnings and profits determine the extent to which a corporation's distributions to its shareholders are dividends rather than a return of capital. Although a deficit earnings and profits account would permit a corporation to make nontaxable return of capital distributions to its shareholders,** Conrail will be a wholly-owned member of Norfolk's consolidated group and thus its distributions will be nontaxable whether characterized as dividends or as a return of capital. We understand that Norfolk itself has a substantial surplus in its earnings and profits, and thus any distributions by Norfolk to its shareholders would be fully taxable dividends even if they were attributable to distributions from Conrail. Moreover, Norfolk's surplus in earnings and profits would not be offset by any deficit of Conrail even if Conrail were to merge with Norfolk. See section 381(c)(2) of the Code.

Cancellation of Conrail Debt and Preferred Stock

The Northeast Rail Service Act, which directed the Department of Transportation to devise a plan for the sale of Conrail, also directed that Conrail be sold free of the Federal government's existing debt or preferred stock interests. The apparent intent of the legislation was that Conrail be returned to the private sector with a sound capital structure. This intention is reflected in Paragraph 3 of the Memorandum of Intent, which provides that prior to the sale, approximately $850 million of outstanding Conrail debt, including accrued interest thereon, and approximately $2.3 billion par value of Conrail preferred stock, including accrued and unpaid dividends thereon, held by the Federal government would be "cancelled or retired, and contributed to the capital of Conrail." In addition, under Paragraph 6(e)(i) of the Memorandum of Intent, the Federal government would warrant that Conrail will not recognize income on account of the cancellation of Conrail preferred stock or debt.

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* We have not been provided any data on Conrail's earnings and profits. There may be uncertainty as to the exact amount because of the uncertain effects of prior law.

** A carryover of any Conrail deficit in earnings and profits could well be disadvantageous to Norfolk, since it would limit Conrail's ability to issue new preferred stock to outside interests. The market for such preferred stock is predominantly among corporations, for whom dividend distributions are more advantageous than returns of capital.

Under general tax law principles, reflected in section 61(a)(12) of the Code, a corporation may recognize income where it retires outstanding indebtedness at a cost that is less than the face amount of the indebtedness. This discharge of indebtedness principle recognizes that a taxpayer has an economic profit where it borrows money which it is not required to repay in full. Certain exceptions to the discharge of indebtedness principle are enumerated in section 108 of the Code, including that a corporation does not recognize income where a shareholder contributes indebtedness to the corporation's capital (provided that the shareholder's basis in the debt is not less than the face amount of the debt). This exception, stated in section 108(e)(6), effectively recognizes that any excess of the amount borrowed from a shareholder over the amount repaid might have been directly contributed to the corporation without causing the corporation to recognize income.

Under the substantive principles described above, Conrail would not recognize income from the cancellation of its debt if such cancellation were treated as a contribution to its capital by the Federal government. Although there is little authority addressing whether a shareholder's cancellation of corporate debt is a contribution to capital, characterization of the cancellation of Conrail's debt as a contribution to its capital would seem probable. The cancellation of Conrail's debt would be structured in this form, the cancellation was directed by Congress, and the practical effect of the cancellation would simply be to enhance the value of Conrail common stock owned or controlled by the Federal government.*

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* The Federal government owns approximately 85% of the common stock of Conrail, with the remaining 15% being held by Conrail Equity Corporation ("CEC"), a subsidiary of Conrail (see discussion below under Transactions Involving Conrail's ESOP).

Even if the cancellation of Conrail's debt were not treated as a contribution to its capital by the Federal government, Conrail's carryforwards would remain available to offset any discharge of indebtedness income to Conrail for a pre-Closing year. Given the size of Conrail's carryforwards in comparison to the amount of its outstanding debt, the warranty that Conrail would not recognize discharge income offers additional protection to Conrail only to the extent such income might be recognized after the Closing, i.e., in a year in which the carryforwards would not be available to absorb the income. Although it may be conceivable that the debt cancellation and sale of Conrail could be recharacterized so as to cause Conrail to recognize discharge of indebtedness income after the Closing, any such income would as a practical matter be attributable to the period in which Conrail was owned by the Federal government. We thus believe it is consistent with the other tax consequences of the proposed sale that Conrail be held harmless from any tax liability arising from the cancellation of its indebtedness. A warranty providing for this result is additionally appropriate given that the cancellation is directed by legislation.

The proposed sale agreement also warrants that Conrail will not recognize income from the cancellation of its outstanding preferred stock. Under general tax law principles, a corporation does not recognize income upon a reacquisition or cancellation of its own stock. Thus, absent a recharacterization of the transaction, Conrail should not recognize income from the cancellation of its preferred stock.

Although we are uncertain as to why this warranty was requested, it might conceivably be out of a concern that Conrail's preferred stock could be characterized for tax purposes as indebtedness, and thus that Conrail may recognize income from its cancellation. There is little authority indicating under what circumstances an investment denominated as preferred stock could be recharacterized as debt for tax purposes. We nevertheless view the possibility of such recharacterization in Conrail's circumstances as remote. Recharacterization of any substantial portion of Conrail's preferred stock as debt could push Conrail near or into insolvency.

Transactions Involving Conrail's ESOP

Approximately 15 percent of Conrail's common stock is beneficially owned by Conrail's employee stock ownership plan

("ESOP").* Paragraph 2 of the Memorandum of Intent provides that, at or prior to the Closing, Norfolk or Conrail shall have made appropriate arrangements with respect to the employees of Conrail to accomplish the acquisition by Norfolk of such employees' 15 percent beneficial interest in Conrail. While we understand that separate negotiations between Norfolk and Conrail's employees are still pending, Exhibit A to the Memorandum of Intent indicates that Norfolk proposes to transfer $375 million in cash or Norfolk common stock to Conrail's ESOP.

To the extent that Norfolk's transfer to Conrail's ESOP is in exchange for the ESOP's beneficial interest in Conrail's stock, such amounts would not be deductible contributions by Norfolk but rather costs incurred in acquiring Conrail's stock. On the other hand, to the extent that the amount of Norfolk's transfer to Conrail's ESOP exceeds the value of the ESOP's beneficial interest in Conrail's stock, such amount could be a deductible contribution by Norfolk, subject to the deduction timing rules of Code section 404 (including section 404(j)) and the continued qualification of Conrail's ESOP. The enabling legislation specifically provides that no inference is to be drawn from the provisions of that legislation regarding either the allocation of Norfolk's $375 million transfer between the purchase of Conrail's stock and deductible contributions to the ESOP or the deductibility of any portion of such transfer by Norfolk to Conrail's ESOP.

If the form of Norfolk's arrangements with Conrail's employees were to cause disqualification of Conrail's ESOP, such employees generally would be currently taxable on the value of their beneficial interest in the trust. In this regard, section 132 of the enabling legislation provides that Conrail's ESOP and related trusts maintained, amended, or adopted in implementing the Secretary of Transportation's plan for the sale of Conrail shall be deemed to meet the qualification requirements of sections 401 and 501, notwithstanding that such plans may not meet the requirements of Code section 415 (which relate to limitations on contributions and other additions with respect to participants in a qualified plan) or that participants in such plans may be entitled to withdraw a portion of the shares allocated to their accounts prior to the expiration of the two-year period generally imposed by the IRS for qualified plans (see Treas. Regs. § 1.401-1(b)(1)(ii)). Although Norfolk's arrangements with Conrail's employees have not been finalized, we believe it appropriate, given the possibly unique form of such arrangements and the unusual structure of Conrail's ESOP, to waive by legislation these two possible technical violations in order that Conrail's ESOP maintain its qualification.

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* CEC, all of the common stock and approximately 50 percent of the preferred stock of which is owned by Conrail, currently owns approximately 15 percent of the common stock of Conrail. The other 50 percent of CEC's preferred stock is owned by Conrail's ESOP. Under existing agreements, Conrail's ESOP by 1991 would own 100 percent of CEC's preferred stock which would then be exchanged for the 15 percent of Conrail's common stock held by CEC.

** It should be noted that under Paragraph 12(b)(viii) of the Memorandum of Intent Norfolk and Conrail are prohibited for at least five years from obtaining a reversion of any excess assets held in connection with Conrail's Supplemental Pension Plan. A reversion of plan assets to either Norfolk or Conrail would not be permissible unless and until the plan is terminated and all liabilities of the plan to the employees are fully satisfied.

Sincerely,

Ronald A. Pearlman

Ronald A. Pearlman
Assistant Secretary
(Tax Policy)

The Honorable
John C. Danforth, Chairman
Subcommittee on Surface Transportation
Committee on Commerce, Science
and Transportation
United States Senate
Washington, D.C. 20510

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

Dear Mr. Chairman:

On April 4, 1985, you sent me three written questions concerning the proposed sale of Conrail to the Norfolk Southern Corporation. I have set forth below the complete text of those questions and my responses. Responses to other questions, propounded by Senator Byrd and Senator Biden, are not primarily related to the tax treatment of the proposed sale and will be submitted by the Department of Transportation.

"1. Mr. Ross, you have described the tax treatment of Conrail assets in the proposed sale. What role, if any, did Treasury play in the Department of Transportation's evaluation of the individual bids for Conrail?"

The Treasury Department's Office of Tax Policy reviewed the tax-related aspects of various individual bids for the purchase of Conrail. Our analysis of individual bids reflected our general advice to the Transportation Department that a purchaser of Conrail not obtain tax benefits that would not be available in an analogous private transaction and that the Internal Revenue Service not be prevented by the sales agreement or enabling legislation from treating Conrail and its purchaser in the same manner as any other taxpayer. In addition, we advised that any purchaser of Conrail be required to relinquish all of Conrail's pre-acquisition net operating loss, investment tax credit, and other carryforwards. We believed this special treatment of Conrail's tax carryforwards was appropriate because these tax attributes arose during the period of the Federal government's ownership of Conrail and are primarily attributable to the Federal government's investment in Conrail.

"2. What role, if any, did Treasury play in the Justice Department's review of the antitrust implications of the sale of Conrail?"

The Treasury Department played no role in the Justice Department's review of the proposed sale.

"3. To your knowledge, are there any tax aspects of the divestiture of rail lines by Conrail and Norfolk Southern that might affect the competitive viability of the acquiring railroads?"

We do not know the assets that will be divested by Conrail or Norfolk Southern, the precise nature of the contemplated transactions, or the tax profiles of the prospective purchasers. Although our analysis of the tax implications of possible divestitures is thus limited, we are not aware of any tax aspects of such transactions that would affect the competitive viability of the acquiring railroads. We anticipate that the rail lines will be sold to third parties as ordinary asset sales. If so, the tax basis of the assets to the purchaser would simply be the cost of the assets to the purchaser and none of Conrail's tax attributes would carry over to the purchaser.

Yours very truly,

Dennis Ross
Acting Deputy Tax Legislative Counsel

The Honorable
Strom Thurmond
Chairman, Committee on the Judiciary
United States Senate
Washington, D.C. 20515

The CHAIRMAN. I would just ask you this one question. In your opinion, has the Department of Transportation met the requirements of the law in matters of this kind, so far as the tax angle is concerned?

Mr. ROSS. Yes, Mr. Chairman. The transaction as conceived in the Memorandum of Intent and the enabling legislation that has been proposed by the Department of Transportation very much follows current tax principles. It departs from those only, really, in respects that are for the most part unfavorable to Norfolk Southern, the purchaser.

The CHAIRMAN. If you will answer the other questions for the record.

Mr. ROSS. Yes, Mr. Chairman.

The CHAIRMAN. Do you have any questions, Senator Hatch?

Senator HATCH. No, Mr. Chairman.

The CHAIRMAN. Senator Metzenbaum, do you have any questions?

Senator METZENBAUM. Yes, I think I do.

Have you made any determination as to what the total amount of tax revenues that will result from the sale of Conrail to Norfolk Southern?

Mr. ROSS. As such, Senator Metzenbaum, we have not. I suppose it would require a forecast of a number of things, which we simply have not undertaken—Conrail's future tax liabilities—all of that would be very contingent on factual circumstances which are for the most part speculative.

Senator METZENBAUM. Are you in a position to make an analysis based upon the figures that I read in the paper this morning, and that I gather were given to Congressman Dingell's committee; can you make such an analysis for us if we give you the figures that were used by, I think it was either the U.S. Railway Association—yes, the U.S. Railway Association—will you do that for us?

Mr. ROSS. To the extent we can. I am still not exactly sure what it is you would like us to do. If it is an analysis——

Senator METZENBAUM. Tell us how much money it may cost the Federal Government in lost tax revenues if this transaction is completed.

Mr. ROSS. Well, we could do that, but we would probably have to do it on alternative assumptions as to certain points.

Senator METZENBAUM. Fine, that would be fine.

Do you have any figures at all at hand, or do you know whether or not there will be lost tax revenues by reason of this sale?

Mr. ROSS. Well, we discussed this in the letter that I have attached to my statement in some detail. The general answer we give there is probably not, that Conrail does not pay taxes currently—there is no risk of a shortfall in revenue from Conrail's side, and if anything, the proposed transaction would move Conrail into a taxpaying position somewhat earlier than if current circumstances continue.

There is an issue, which we identify in the letter, as to whether or not Norfolk may be able to utilize tax attributes of Conrail to offset its own income tax liability. The answer we suggest there is that there is no certain way to say whether restrictions which you previously discussed with Mr. Rooney, the so-called built-in deduction limitations, would apply so as to prevent Norfolk from having access to Conrail tax losses. It is a factual issue, and again, it would require some conjecture on our part as to how that factual issue would be resolved.

Our sense is that, based on the proposed sale figures, Conrail would not meet the so-called de minimus exception to those restrictions. If you start with a $1.2 billion sale price, perhaps gross it up to some extent for amounts that would be paid to Conrail's ESOP, take into account even liabilities of Conrail that might be assumed, it is still difficult to see how the total value of Conrail's assets on those figures would put Conrail in a position to satisfy that de minimus test. And again, the de minimus test is that the fair market value of Conrail's assets—and you would have to for this purpose exclude cash and certain other items—would equal 85 percent of its adjusted basis, which is in excess of $3 billion. So you would have to get a fair market value of assets, again excluding cash, of something around $2.5 billion or more. And the facts—again, we have not studied this conclusively, and it is a factual issue—but the value placed on Conrail's stock suggests that they would not meet that test.

Again, this point is discussed in the letter I have attached to my statement.

Senator METZENBAUM. And in that letter you say, "If Norfolk can use Conrail tax benefits, it would have an adverse impact on revenue"—right?

Mr. ROSS. Certainly. Norfolk would, presumably, by virtue of using those attributes, reduce the income tax it would otherwise pay to the Government.

Senator METZENBAUM. Then you say but there is a de minimus exception.

Mr. ROSS. That is right.

Senator METZENBAUM. And then you say, "Since we do not have appraisals or other direct information concerning the fair market value of Conrail's assets, it is not certain that Conrail would not satisfy the de minimus exception."

Mr. ROSS. That is accurate. It is not certain. It would require conceptually an actual appraisal of Conrail's assets. But if the IRS were to think about—or, if this issue were to come before a court, the court would have certain evidence, admittedly indirect, of the value of Conrail's assets. It would start, I think, with the price paid for Conrail's stock. It would have on hand whatever other bids were made for Conrail's stock, whatever other appraisals had been made: In this context, for example, the appraisal of the public offering value of Conrail. It would thus have some evidence of the value of Conrail's assets. It might go on and require direct appraisals, and that might be how the issue would be resolved.

Senator METZENBAUM. Well, as a matter of fact——

Mr. ROSS. Again, the answer to your question is that it is not certain.

Senator METZENBAUM. Well, as a matter of fact, assuming you were in private practice, and you wanted to tell Norfolk how to use Conrail's $3 billion base, would you not suggest to them that they might be able to move some of their volume and their operations into Conrail and let Conrail make more profit in order to be able to take advantage of that $3 billion?

Mr. Ross. I would be cautious in giving that advice, because there are provisiosn of the law –section 269 of the Internal Revenue Code is what I have in mind—that say that if you acquire assets, or control of a corporation with a tax avoidance purpose, the use of deductions which are obtained from that purchase can be denied to you. Again, if the Government could establish a principal purpose of tax avoidance——

Senator METZENBAUM. Well, you do not want to mislead us about section 269, because section 269 is only where you make an acquisition to evade or avoid income tax; isn't that so? That section is specific language, it is very tight language, and almost never is used. But it is a section that has to do only with making an acquisition for the purpose of evading or avoiding income tax.

Mr. Ross. Well, if you refer to my letter, you will see that we cite regulations under section 269 which address exactly the kind of case you are talking about, an acquisition of a corporation with losses, and having the income from those transferred assets absorb the losses. The regulations suggest, absent other circumstances in the transaction, that will ordinarily be a case in which section 269 is invoked.

Now, I do not want to tell you that section 269 is foolproof; it is not. It is not always invoked. A principal purpose test, which is the standard under section 269, it is often difficult for the IRS to win. And that might be the case here.

But in response to your initial question, would I as a private lawyer advise Norfolk Southern to do that, again, I would have to say that I would be cautious in giving them that advice.

Senator METZENBAUM. Cautious. But now, they would not have to do it by transferring assets; couldn't they just transfer some of their volume, some of their income, or in other words, shift some business from one railroad to the other?

Mr. Ross. Well, but that is a form of asset transfer. I do not think that would take them out of section 269.

Senator METZENBAUM. What do you mean, that is a form of asset transfer? Let's assume that they are getting a shipment—and I will make this up—that is going from Cleveland to Chicago, and they could take it one way or take it the other way. If they take it on Conrail's lines, they can use up some of their loss, or they can produce some income for Conrail and therefore use up some of the loss. If they take it on the other route, they are not able to do that. So that is not a transfer of assets under section 269, is it?

Mr. Ross. Well, I think it would be under section 269. The issue is not so much whether you are transferring assets, but whether the initial purpose of the acquisition was to gain the benefit of certain deductions that you would not otherwise——

Senator METZENBAUM. Nobody could—in order to bring section 269 into application, you would have to prove that the original purpose of Norfolk Southern was to pick up the losses of Conrail in order to evade or avoid taxes. Now, nobody in his right mind would attempt to claim, and I certainly would not claim, that Norfolk's objective in making this deal is to evade or avoid taxes. There are 20 other reasons for them to make this.

Section 269 was applicable and was intended where one corporation went out and found another company that had $20 million or $200 million in losses and then went and bought that company, and a lot of people did that over a period of some years, and therefore, section 269 came into play.

Mr. Ross. Well, that is the easiest case. That is not the only case.

Senator **Metzenbaum**. Well, I understand that. But it does relate only to the cases where there was the original intent to evade or avoid taxes, right?

Mr. Ross. Well, I think that is right, but that sort of intent can be proved, and the regulations again give this as an example, by subsequent actions, and one of those actions would be to transfer assets or income to the lost corporation.

The **Chairman**. Have you finished your questions?

Senator **Metzenbaum**. No; I have a few more—in fact, I guess I have several more, in all fairness. So, if Senator Hatch has some questions——

The **Chairman**. Senator Hatch, do you have any questions?

Senator **Hatch**. No questions, Mr. Chairman.

Senator **Metzenbaum**. Would Treasury support an amendment that would prevent Norfolk Southern from directly or indirectly using Conrail's tax write-offs to offset Norfolk Southern income, just to be certain that it would not happen?

Mr. Ross. Well, again, we have prevoiusly advised the Department of Transportation that in our view of the transaction, and again on an analysis that ordinary tax consequences should obtain, that would be inconsistent with ordinary tax consequences. I do not think we would oppose it. It is obviously in the Government's favor.

The issue would be, I think, from the DOT's standpoint, what that does to the value of Conrail.

If I might just embellish, Senator, on an answer I gave you a moment ago, Mr. Rooney reminds me—and we point this out, also, in the letter we sent to Senator Danforth—that there are nontax reasons why Norfolk might be hesitant to transfer assets to Conrail—contingent liabilities of Conrail, the restrictions on taking assets out of Conrail. Once assets or income are moved inside of Conrail, Norfolk may have a tough time getting them back out.

Senator **Metzenbaum**. Yes; but again, I say to you, I am not only talking about transfers of assets. And I must say to you, I challenge your——

Mr. Ross. Well, income would have the same effect there.

Senator **Metzenbaum**. Income may have the same effect, but the regulations and statutes do not relate to that, do they?

Mr. Ross. I believe they do. Again, the issue addressed in the regulations is not whether you are transferring assets or income. It is what such a transfer suggests about your initial purpose in making the acquisition. And I do not think they would be distinguishable for that purpose.

Senator **Metzenbaum**. How much are the net operating losses that the agreement provides will be forfeited by Norfolk Southern worth to the U.S. Treasury?

Mr. Ross. I am sorry. I did not understand the question.

Senator **Metzenbaum**. There are some net operating losses that Conrail presently has.

Mr. Ross. That is right.

Senator **Metzenbaum**. The agreement provides that Norfolk Southern cannot use them.

How much are they worth to the U.S. Treasury by their doing that?

Mr. Ross. Well, it is very hard to speculate on their value. It requires an assumption about when they would be used and by what taxpayer. The gross amount is, I think, in excess of $2 billion, and the potential loss in revenues if they were transferred to Norfolk Southern would depend on at what point in time they would be used.

It is very hard to speculate. In fact, that is one of the reasons we insisted, really, that they not be included in the transaction.

Senator **Metzenbaum**. But wasn't there an analysis of that made, I think, by Greider—I think the name is Greider, and I forget where I read it—an article in which he points out that even if they did not have that clause in there, that they would still get the same advantages because they would be able to add the $2 billion into the loan base?

Mr. Ross. I know the article you are referring to. I do not remember that passage in it.

Senator **Metzenbaum**. I think he makes that point in it, that it really does not mean as much as it would appear to mean on its face.

Mr. Ross. Well, I think maybe the point he was making was that the Government, if it sells net operating losses, will lose when a taxpayer uses those net operating losses to reduce his tax liability. So in that sense, you have at best, a wash. If that was his point, he is clearly right.

Senator **Metzenbaum**. Right.

The **Chairman**. Do you have any other questions?

Senator **Metzenbaum**. Yes, I do.

In your testimony, you say that if Norfolk Southern can shelter its income with Conrail writeoffs, there would be an adverse impact on revenue. Do I understand you to say that you have not computed how much that would be?

Mr. Ross. Again, it would depend on how fast—let us assume for a moment that the built-in deduction rules did not apply, and thus, the Norfolk was free to use whatever tax losses Conrail generated. The value of that ability to use those losses would depend on how much Conrail's earnings are, thus, whether or not there really would be losses—I suppose that would be the first issue you would have to address—and then beyond that, the amount of Norfolk's earnings.

Senator **Metzenbaum**. Well, assuming they remain as at present or thereabouts, are you not in a position to advise us as to what those tax losses would be?

Mr. Ross. If we made two assumptions—first of all, how much Conrail had as income, and second, how much Norfolk had as income, we probably could come up with an estimate of what that would be. Again, it is all contingent on the built-in deduction limitations not being applicable.

Senator **Metzenbaum**. I would appreciate Treasury advising us as to what those losses would be, following the U.S. Railway Association's projections and following such other projections as you or Norfolk Southern or Conrail or anybody else give you, so that we may have the benefit of your thinking.

Mr. Ross. I would be happy to do that.

Senator Metzenbaum. How much of the $3 billion tax basis, if it is usable, is attributable to sums paid by the Treasury in the form of capital contributions or the original Government purchase price of the bank of railroad' loans, et cetera?

What I want to know is how much of the depreciation deduction that are to be allowed under the proposed terms of sale were in the last analysis paid for by the taxpayers of this country in the first instance?

Mr. Ross. Well, our conclusion was that there was very little, Senator, because Conrail's tax basis, at least roughly, in 1976. Was also in excess of $3 billion. And the difference between the two is, at least given the gross figure, not very substantial.

Senator Metzenbaum. Yes, but then the Federal Government put $7 billion in it; is that right?

Mr. Ross. It did, and it generated in excess of $2 billion in net operating losses, and a slew of investment tax credits that they could not use. I mean, those $7 billion were absorbed. But in terms of the impact on tax basis, Conrail coming into the Government and going out really is not in a much different position. It had in excess of $3 billion in asset basis going in, and I think it leaves with maybe a little more, but not much.

Senator Metzenbaum. Yes, but I guess what concerns me is here is a company that had $3 billion in assets 9 years ago, I guess—what was it, 1974——

Mr. Ross. Seventy-six, I think.

Senator Metzenbaum [continuing]. Whatever, whenever it was purchased—8 or 9 or 10 years after. Certainly, much of that had been depreciated down. The Federal Government comes in and puts in $7 billion; a lot of new assets are purchased, and those are depreciable.

My question is doesn't it appear to you that the people put the money in, paid for these assets, and now, those assets that the people paid for are going to provide a reduction in taxes, and therefore, the rest of the people in this country are going to have to absorb those same costs.

Mr. Ross. Well, I am not sure it is accurate to say there would be, again, a reduction in taxes. There were assets again preexisting in Conrail that had, again, roughly the same asset basis. Those assets were, as you say, depreciated over time, but they generated net operating losses, or they offset Conrail's income during the period, and the effect of that is now being terminated, or, those net operating losses are not being carried forward.

Again, if you view it just in terms of what basis was in the private sector, thus, what stream of depreciation deductions was in the private sector before the Federal Government became involved with Conrail, and now what basis is going back out into the private sector, there really is not much difference. And on that analysis, I think it is hard to conclude that the taxpayers are funding this depreciation.

Senator METZENBAUM. Well, Mr. Ross, if somebody else had owned this for the last 8 or 9 years, that $3 billion presumably would be worth maybe half a billion now—the original $3 billion—it may be less than that. It probably would be pretty well depreciated down. So the only basis now that exists comes about by reason of the $7 billion that the Federal Government put in—isn't that so?

Mr. ROSS. Well, but it is received in one hand and paid out with the other—I am not sure that is the right phrase. My point would be this, that the basis that was originally in Conrail—clearly, that had been depreciated to some extent; I do not know the actual extent—but that would have generated or increased net operating losses that Conrail incurred, and those net operating losses are being relinguished now.

If you want to use the model of what would have happened had a private taxpayer been involved with Conrail and made the same investment, he would have had perhaps a smaller basis now. The depreciation deductions from his preexisting investment, the $3 billion in 1976, would have generated losses, and that taxpayer would, at least, under certain circumstances, be able to pass those losses on to other owners of Conrail. Again, that is not happening in this transaction.

Senator METZENBAUM. The tax basis for Conrail, that is, the amount that determines how much depreciation is allowed, is derived from the old bank of railroads that were combined into the Conrail system. Will the provision that bars IRS challenges also bar Conrail or Norfolk Southern from going to court and trying to increase the tax basis, and thus, the corresponding tax deduction? That is, can they challenge the original basis assumed by Conrail or any other depreciation allowances in order to increase their future deductions, while the IRS is barred from attempts to reduce them?

Mr. ROSS. I think the short answer is no. But if I could just address your suggestion that the IRS is barred from challenging Conrail or Norfolk on certain tax matters—that is not accurate. There is a warranty in the agreement that if Conrail's basis is successfully challenged by the IRS, Conrail and Norfolk Southern could bring suit against the United States, to the extent the challenge increases Conrail's tax liability, get an offset against certain tax liabilities of Conrail or Norfolk.

We took considerable effort in advising the Department of Transportation to make sure that the IRS would not be prevented from raising any challenge, really, against Conrail with regard to asset basis or other issues.

Senator METZENBAUM. What you are saying is that you may be able to protect the IRS on the one hand, and the Government getting its money that way, but over here, the same Government is going to indemnify the company for anything they have to pay you.

Mr. ROSS. Yes. And you are right to say that economically, that is not a big difference.

Senator METZENBAUM. A total wash.

Mr. ROSS. We thought it significant, though, in terms of the IRS ability to administer the law. There could be issues that it would want to raise with Conrail that might have an effect on other taxpayers or other years of Conrail. We did not want to deny them that ability.

You are right, though, that as an economic matter, the Government will not stand to profit from raising these issues.

Senator METZENBAUM. Has the IRS ever audited Conrail?

Mr. ROSS. To my knowledge, no.

Senator METZENBAUM. If IRS audits Conrail in future years, you will be unable to disallow any previously claimed depreciation deduction, won't you?

Mr. ROSS. No; they would be allowed to.

Senator METZENBAUM. You can do it, but the Government then has got to guarantee it.

Mr. ROSS. Well, if you are talking about audits of preclosing years and the basis reflected on those preclosing years, that is right. The Government has provided a warranty that that basis is accurate. And really, the reason for that warranty is the point you make; the IRS has not previously audited Conrail. And so a purchaser of Conrail—and I think it would be true of Norfolk Southern or true of anyone who bid for Conrail, probably also true in the context of a public offering, would want some comfort that the asset basis reported on Conrail's books is accurate. There is no way for them to get assurance on that point, short of a warranty, given that there has been no audit by the IRS.

Senator METZENBAUM. Does the legislation or Memorandum of Intent contemplate any special court jurisdiction, any special tax procedures, or any special bars on IRS action to enforce the generally applicable Tax Code provisions?

Mr. ROSS. To the last of those, no. There is a special procedure contemplated that would permit Norfolk to bring suit on its warranties. But again, that is not a bar on the IRS auditing Conrail, or raising whatever issues it wants in the context of such an audit.

Senator METZENBAUM. Are you familiar with any other Government sales where the Government gives the kind of warranties that are provided for in this, as against tax liabilities?

Mr. ROSS. I am not.

Senator METZENBAUM. So this would be a precedentmaking step?

Mr. ROSS. I am not sure that is true. The fact that I do not know of them does not mean they do not exist. If I could just respond to that. Whether or not the Government has done this previously, it is very typical of what private parties do when they sell a corporation or even sell assets: they would commonly represent that their tax accounting is accurate and that if it is not, they will indemnify the purchasing party. We, in agreeing to the warranties that were contemplated in this transaction, thought that they should be provided only to the extent they really followed what might be done in a private party transaction.

Senator METZENBAUM. Well, both you and the previous witness attempted to say that this is sort of typical the way business deals are structured. Isn't it a fact that this deal is structured differently, and the language is different, than ordinary sales between two private parties, and that in this deal, the Government warrants future tax interpretations and interpretations of actions predicated upon this sale itself, whereas in private transactions, that is never done, and the only thing that is done is that the seller warrants that the statement that has been given is correct and accurate, and that if there is an IRS audit of previous years' operations and taxes are due, then the seller will warrant to make up the difference by reason of that deficiency, if any—and that is a totally different situation than what the government has done in this instance; am I not correct?

Mr. Ross. Well, I do not think it is different in that private parties would never do that.

Senator **Metzenbaum**. Tell me one contract you think of where private parties agree as to what the tax interpretation will be, and that the seller will warrant what the tax interpretation will be, with respect to the manner of handling the sale itself or the manner of any future action of the corporation. The only thing you ever get is that there may be a provision for getting a tax ruling vis-a-vis the sale itself—that is oftentimes done—is it a tax-free stock transaction, et cetera. But this is a warranty. This is not a matter of getting an interpretation. This is a warranty that the law will protect the buyer with respect to the sale and future tax deductions, as well. And isn't that totally different?

Mr. Ross. Well, again, if the reference point is what private parties do, I do not think it is totally different. One case I would think of would be transactions in which ownership of an asset is determinative of who gets certain tax benefits—so-called sale/leaseback transactions.

Senator **Metzenbaum**. Sure, I understand that, where the question is who gets the tax benefits, but that is not a warranty as to how the tax law——

Mr. Ross. Well, they would provide, typically, that if it turns out that the IRS challenges that, and the owner of the transaction as contemplated by the parties is not so treated by the IRS but the seller is treated as retaining ownership so that the tax consequences anticipated and really priced into the transaction are very different, the seller would indemnify the purchaser.

Senator **Metzenbaum**. Those are shelter deals.

Mr. Ross. Well, not always, but——

Senator **Metzenbaum**. Pretty much.

Mr. Ross. Well, they are certainly tax-sensitive.

Senator **Metzenbaum**. I have no further questions, Mr. Chairman. I thank you for your patience.

The **Chairman**. Thank you.

It is now 12:30. We have two shippers panels, and we have a ports panel. So, when we come back at 2, we will take the shippers panel first.

We are now in recess until 2.

[Whereupon, at 12:30 p.m., the committee was recessed, to reconvene at 2 p.m. this same day.]

[Whereupon, at 2:10 p.m., the committee reconvened, Hon. Strom Thurmond, (chairman) presiding.]

The **Chairman**. The committee will come to order.

As President pro tempore, I had to open the Senate, and I am sorry to have delayed a few minutes.

We now have some shippers to hear from. The first panel is James A. Scahill, vice president of Pennsylvania Coal Mining Association, Harrisburg, PA; Mr. Glenn Schleeded, president of New

England Energy, Inc.; Mr. E. Morgan Massey, president, A.T. Massey Coal Co.; Mr. Robert Edwards, vice president of traffic of the Early & Daniel Co., and Mr. George L. Berg, assistant director of national affairs division of the American Farm Bureau Federation.

Now, gentlemen, we will give each of you 5 minutes, and without objection, we will put all of your statements in the record.

So, you may proceed, Mr. Scahill.

STATEMENT OF A PANEL OF SHIPPERS, INCLUDING JAMES A. SCAHILL, VICE PRESIDENT, PENNSYLVANIA COAL MINING ASSOCIATION, HARRISBURG, PA; GLENN SCHLEEDED, PRESIDENT, NEW ENGLAND ENERGY, INC., WESTBOROUGH, MA; E. MORGAN MASSEY, PRESIDENT, A.T. MASSEY COAL CO., INC., RICHMOND, VA; ROBERT A. EDWARDS, VICE PRESIDENT OF TRAFFIC, THE EARLY & DANIEL CO., CINCINNATI, OH; AND GEORGE L. BERG, JR., ASSISTANT DIRECTOR, NATIONAL AFFAIRS DIVISION, AMERICAN FARM BUREAU FEDERATION, WASHINGTON, DC

Mr. SCAHILL. Thank you, Mr. Chairman.

I am James Scahill, executive vice president of the Pennsylvania Coal Mining Association, representing over 100 surface coal mining companies in Pennsylvania.

It should be noted that there are over 700 coal companies in Pennsylvania, the vast majority of which are termed "captive shippers", with Conrail hauling 46 percent of the coal produced in the State. The current dialog about selling Conrail is of tremendous importance to our companies in Pennsylvania.

When the Penn Central failed in the seventies, it was devastating to our markets, leading buyers to move to coals transported outside of Pennsylvania. Out of the ashes of the Penn Central came Conrail. Conrail has done a good job. Conrail has shown themselves to be a very reliable shipper of our product, enabling us to get to market, enabling us to regain some of our markets that we lost over the years.

The Pennsylvania Coal Mining Association's position on this critical issue is quite simple. PCMA supports Senate bill 464 that forbids the purchase of Conrail by the Norfolk Southern Corp., and Senate bill 465, that calls for a public stock offering to accomplish the sale. The economics of such a bargain sale to Norfolk have been adequately addressed by the prime sponsor of the bills, and I might add that in my testimony I had the wrong Senator—I apologize to the prime sponsor, Senator Specter.

Senator Specter also outlines in the Congressional Record the antitrust implications.

The promises made by Norfolk Southern to maintain competition are empty. In fact, they seem to be making more promises than the politicians. PCMA finds it curious that Norfolk Southern has not taken the time to meet with one of Conrail's major customers in Pennsylvania, the coal industry, which constitutes 31 percent of the freight that is moved by Conrail. One could say this is just an oversight, or possibly premature. We believe it is because the Norfolk Southern does not really care what we think. After all, if they get Conrail, we will have to ship on their railroad, or not ship at all.

The crux of the problem is competition. Congress attempted to create this competition with the passage of the Staggers Act in 1980. Four years later, we find that the only major railroad that is attempting to be competitive in any large degree is Conrail.

The record speaks for itself. The following comparison—and I have it in the testimony—is a comparison of Conrail, the Norfolk & Western, which is the main division of the Norfolk Southern system which competes with Conrail, and the Norfolk Southern system these are 1983 figures, the latest available.

It is interesting to note that the average revenue per ton of coal for Conrail was $7.74. The average revenue for the Norfolk & Western is $10.91—a difference of $3.17 per ton. If you take the figure of 31 million tons that was hauled by Conrail in 1983, that difference would be $98.2 million in just what I would call windfall profits by Norfolk Southern taking over Conrail. That is in just one State, yet constitutes 8.2 percent of Norfolk's offer for Conrail. We find that ridiculous.

I also find that even though coal makes up 31 percent of Conrail's freight currently, and in the table it shows, it is only 18 percent of Conrail's total revenues. This has been what I would call competition.

As mentioned, we are captive shippers of a product that is hard to sell. Conrail has worked hand-in-hand with the Pennsylvania coal industry to develop export strategies, including the development of the Port of Philadelphia as a major coal shipping point. The Norfolk promise to the people of Philadelphia is that they will increase coal transportation seven times the present production rate. Anyone who understands the soft export coal market can tell you that Norfolk Southern will have to either switch coal destined for Hampton Roads for a short period of time, or dump it in the ocean to achieve such laudable goals.

To Pennsylvania producers, this is just what it is: An empty promise. The Norfolk Southern has 1,200 miles of tracks that are in direct competition with Conrail, and you will find that there is a $3 to $4 difference in rates. Conrail has provided that competition even though they did not have to, and they have done it for the simple reason that we believe Conrail wants to be competitive; we believe in the public sale.

Also, at this time, I would like to state for the record the opposition of the Mining and Reclamation Council of America to the sale of Conrail to the Norfolk Southern Railroad——

The Chairman. Your time is up. Thank you.

[The following was received for the record:]

TESTIMONY OF
JAMES V. SCAHILL OF THE
PENNSYLVANIA COAL MINING ASSOCIATION

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I AM JAMES SCAHILL, EXECUTIVE VICE-PRESIDENT OF THE PENNSYLVANIA COAL MINING ASSOCIATION (PCMA), A TRADE ASSOCIATION OF OVER 100 SURFACE COAL MINING COMPANIES IN PENNSYLVANIA. IT SHOULD BE NOTED THAT THERE ARE OVER 700 COAL COMPANIES IN PENNSYLVANIA. THE VAST MAJORITY OF THESE COMPANIES ARE TERMED "CAPTIVE SHIPPERS", WITH CONRAIL HAULING 46% (31 MILLION TONS) OF THE COAL PRODUCED IN THE STATE. THE CURRENT DIALOGUE ABOUT SELLING CONRAIL IS OF TREMENDOUS IMPORTANCE TO OUR COMPANIES IN PENNSYLVANIA.

HISTORICALLY, PENNSYLVANIA HAS BEEN THE NO. 1 PRODUCER OF COAL IN THIS NATION, ACCOUNTING FOR OVER 30% OF NATIONAL PRODUCTION SINCE THE START OF THE INDUSTRY IN THE LAST CENTURY. THE PAST TWENTY YEARS HAVE NOT BEEN SO KIND TO PENNSYLVANIA, WHICH FINDS ITSELF WITH DECLINING PRODUCTION AND THE RESULTANT ECONOMIC AND EMPLOYMENT LOSS. MOST OF THE BLAME FOR THIS DECLINE HAS BEEN ATTRIBUTED TO ENVIRONMENTAL REGULATIONS THAT HAVE HAMPERED PENNSYLVANIA COALS MARKETABILITY DUE TO OUR COAL'S MEDIUM TO HIGH SULFUR CONTENT. OFTEN OVERLOOKED AS A CAUSE FOR OUR DECLINE IN PRODUCTION WAS THE BANKRUPTCY OF THE PENN CENTRAL RAILROAD AND OTHERS IN THE EARLY '70'S. TRANSPORTATION OF PENNSYLVANIA COAL HAS ALWAYS BEEN RAILROAD-DEPENDENT. THE FAILING OF THE PENN

CENTRAL WAS DEVASTATING TO OUR MARKETS, LEADING BUYERS TO MOVE TO COALS TRANSPORTED OUTSIDE OF PENNSYLVANIA.

OUT OF THE ASHES CAME CONRAIL. MANY STATED AT THE TIME THAT THE CONCEPT OF CONRAIL WOULD NOT WORK. PCMA BELIEVES THAT IT IS QUITE OBVIOUS THAT CONRAIL WORKS, AND WORKS WELL. SO WELL IN FACT, IT HAS BECOME AN ATTRACTIVE COMPANY SOUGHT BY MANY OTHER CORPORATIONS. CONRAIL COULD HAVE JUST AS EASILY FAILED BUT DIDN'T. PCMA ATTRIBUTES MUCH OF ITS SUCCESS TO THE MANAGEMENT TEAM HEADED BY STANLEY CRANE, ALONG WITH THE CONRAIL WORKERS, WHO HAVE COLLECTIVELY PROVEN THEY CAN OPERATE A RAILROAD SUCCESSFULLY. MR. CRANE, THE ONE PERSON WHO DESERVES THE GRATITUDE AND THANKS OF THIS GOVERNMENT FOR HIS SUCCESS, HAS INSTEAD BEEN PERSONALLY ATTACKED BY MEMBERS OF THE ADMINISTRATION WHO QUESTION HIS MOTIVE IN ADVOCATING A PUBLIC SALE OF THE RAILROAD. COULD IT SIMPLY BE THAT STANLEY CRANE WANTS TO SEE CONRAIL TO CONTINUE TO BE A SUCCESS? PCMA BELIEVES THAT THESE ATTACKS HAVE BEEN UNWARRANTED, AND ONLY CLOUD THE ISSUE OF THE SALE.

THE PENNSYLVANIA COAL MINING ASSOCIATION'S POSITION ON THIS CRITICAL ISSUE IS QUITE SIMPLE. PCMA SUPPORTS S. 464, THAT FORBIDS THE PURCHASE OF CONRAIL BY THE NORFOLK SOUTHERN CORPORATION; AND S. 465, THAT CALLS FOR A PUBLIC STOCK OFFERING TO ACCOMPLISH THE SALE. THE ECONOMICS OF SUCH A BARGAIN SALE TO NORFOLK HAVE BEEN ADEQUATELY ADDRESSED BY THE PRIME SPONSOR OF THE BILLS, SEN. JOHN HEINZ. (*Congressional Record*, Vol. 131, No. 15, 2-19-85) [EXHIBIT A]

THE MAIN REASON PCMA IS STRENUOUSLY OPPOSED TO THE SALE OF CONRAIL TO NORFOLK SOUTHERN IS COMPETITION, THE VERY REASON YOU ARE HOLDING THIS HEARING. THE ANTI-TRUST IMPLICATIONS OF SUCH A SALE ARE FRIGHTENING TO CAPTIVE SHIPPERS. PRESENTLY, THERE ARE THREE MAIN COAL HAULERS IN OUR AREA--THE CHESSIE SYSTEM, NORFOLK SOUTHERN, AND CONRAIL. ELIMINATION OF CONRAIL LEAVES JUST TWO, NO MATTER HOW YOU SLICE THE PIE. SEN. HEINZ OUTLINES ANTI-TRUST IMPLICATIONS IN THE CONGRESSIONAL RECORD MENTION. THE BOTTOM LINE IN ACHIEVING COMPETITION IS TO HAVE ENOUGH PLAYERS AROUND TO JUSTIFY IT. PCMA BELIEVES THAT A SALE OF CONRAIL TO ANOTHER RAILROAD WILL ELIMINATE COMPETITION.

THE PROMISES MADE BY NORFOLK SOUTHERN TO MAINTAIN COMPETITION ARE EMPTY. IN FACT, THEY SEEM TO BE MAKING MORE PROMISES THAN A POLITICIAN. PCMA FINDS IT CURIOUS THAT THE NORFOLK SOUTHERN HAS NOT TAKEN THE TIME TO MEET WITH ONE OF CONRAIL'S MAJOR CUSTOMERS IN PENNSYLVANIA, THE COAL INDUSTRY (31% OF FREIGHT). ONE COULD SAY THAT THIS IS JUST AN OVERSIGHT OR POSSIBLY PREMATURE. WE BELIEVE IT IS BECAUSE THE NORFOLK SOUTHERN DOESN'T REALLY CARE WHAT WE THINK. AFTER ALL, IF THEY GET CONRAIL, WE WILL HAVE TO SHIP ON THEIR RAILROAD OR NOT SHIP.

THE CRUX OF THE PROBLEM IS COMPETITION. CONGRESS ATTEMPTED TO CREATE COMPETITION WITH THE PASSAGE OF THE STAGGERS ACT OF 1980. FOUR YEARS LATER, WE FIND THAT THE ONLY MAJOR RAILROAD THAT IS ATTEMPTING TO BE COMPETITIVE TO ANY LARGE

DEGREE IS CONRAIL. INCIDENTALLY, PCMA TESTIFIED BEFORE THE SENATE SUBCOMMITTEE ON SURFACE TRANSPORTATION IN JULY 1983 THAT THE STAGGERS ACT SHOULD REMAIN UNCHANGED UNTIL IT HAS AN OPPORTUNITY TO WORK IN NORMAL MARKET CONDITIONS. [EXHIBIT B] THE ONLY RAILROAD TO JOIN IN THAT VIEW WAS CONRAIL. IN FACT, PCMA COULD ONLY TAKE THAT UNIQUE POSITION THROUGH OUR EXPERIENCE WITH CONRAIL, THE ONE RAILROAD THAT HAS ATTEMPTED TO CREATE COMPETITIVENESS.

THE RECORD SPEAKS FOR ITSELF. THE FOLLOWING IS A COMPARISON OF CONRAIL, NORFOLK & WESTERN (main division of NS that competes with Conrail), AND THE NORFOLK SOUTHERN SYSTEM. [EXHIBIT C]

Item	Conrail	N&W	NS
Coal/Total Freight	31%	66%	52%
Coal Revenue/Freight Rev.	18%	52%	36%
Avg. Revenue/Ton Coal	$ 7.74	$10.91	$ 9.30
Total Coal (1000 tons)	$ 62,883	$72,254	115,576
Gross Rev. ($1000)	486,493	788,430	1,074,567

Source: Coal Traffic, 1983 - NCA (ICC figures)

AS, MENTIONED, NORFOLK SOUTHERN IS MAKING A POTFUL OF PROMISES. BY TAKING THE PRESENT RATE DIFFERENTIAL FOR OUR AREA OF CONCERN, PENNSYLVANIA PRODUCERS WILL PAY AN ADDITIONAL $3.17 PER TON TO SHIP OUR COAL, OR AN ADDITIONAL $98.2 MILLION, BASED ON THE COAL HAULED BY CONRAIL IN 1983. GENTLEMAN, THAT IS IN JUST ONE STATE YET CONSTITUTES 8.2% OF NORFOLK'S OFFER FOR CONRAIL. RIDICULOUS. I ALSO FIND THAT EVEN THOUGH

COAL MAKES UP 31% OF CONRAIL'S FREIGHT, IT IS ONLY 18% OF ITS TOTAL REVENUES. SOUNDS COMPETITIVE TO ME.

AS MENTIONED, OUR OPERATORS ARE CAPTIVE SHIPPERS OF A PRODUCT THAT IS HARD TO SELL. CONRAIL HAS DEVELOPED MARKET STRATEGIES THAT WILL ENHANCE PENNSYLVANIA COAL. [EXHIBIT D] IT IS OUR BELIEF THAT NORFOLK SOUTHERN IS ONLY INTERESTED IN EXPLOITING THE NORTH-SOUTH CORRIDOR THE CONRAIL ACQUISITION WOULD GIVE IT. PENNSYLVANIA PRODUCERS WOULD SIT AND COUNT TRAINS PASSING THROUGH THE STATE LOADED WITH COAL FROM ANOTHER STATE.

CONRAIL HAS WORKED HAND-IN-HAND WITH THE PENNSYLVANIA COAL INDUSTRY TO DEVELOP EXPORT STRATEGIES, INCORPORATING THE DEVELOPMENT OF THE PORT OF PHILADELPHIA AS A MAJOR COAL SHIPPING POINT. THE NORFOLK PROMISE IS TO INCREASE COAL TRANSPORTATION 7 TIMES THE PRESENT PRODUCTION. ANYONE WHO UNDERSTANDS THE SOFT EXPORT MARKET CAN'T TELL YOU NORFOLK SOUTHERN WILL HAVE TO EITHER SWITCH COAL DESTINED FOR HAMPTON ROADS FOR A SHORT PERIOD OR DUMP IT IN THE OCEAN TO ACHEIVE SUCH LAUDABLE GOALS. TO PENNSYLVANIA PRODUCERS THIS IS JUST WHAT IT IS - AN EMPTY PROMISE. ALSO, HOW LONG WILL IT TAKE FOR THERE TO BE A MAJOR CRISIS THAT WILL ENTAIL CLOSING THE CONWAY, ALTOONA OR ENOLA YARDS? COULD IT BE THE OLD STORY OF ELIMINATING COMPETITION INSTEAD OF FIGHTING IT?

IN CLOSING, "THE GREAT TRAIN ROBBERY" WAS THE FIRST MOTION PICTURE. TO PCMA, IT SOUNDS LIKE THE NORFOLK SOUTHERN IS ATTEMPTING TO MAKE A SEQUEL. DON'T LET THEM DO IT.

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of America

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Senate

S. 464—RELATING TO THE SALE OF CONRAIL

Mr. SPECTER. Mr. President, I am today introducing two bills dealing with the sale of Conrail, and I do so at the first available moment on the Senate floor after the proposal by the Secretary of Transportation, Elizabeth Dole, to sell Conrail to Norfolk Southern.

Mr. President, I have been concerned about the sale of Conrail since last June when proposals were made by three private bidders. My first concern arose in connecting with potential harmful consequences to my own State, the Commonwealth of Pennsylvania. During the course of my studies, and further review, I have became very much concerned about the proposed sale of Conrail in terms of the very serious, if not disastrous, consequences which will result for the entire Nation.

It is for that reason that I am today introducing these two bills. The first bill blocks the proposed sale of Conrail to Norfolk Southern. The second bill proposes that in the event that a sale of Conrail is deemed advisable, it proceed by public stock offering, and not by private sale.

Mr. President, I come to the views which I hold as a result of extensive consultation with labor and business, both within Pennsylvania and outside of my State, and after consultation with the ~~Secretary~~ of Transportation, Elizabeth Dole.

In addition to those meetings, I have studied voluminous documents, and I have participated in six hearings. Three hearings were held in Pennsylvania late last year—October in Harrisburg, in December in Philadelphia, and in January in Pittsburgh. Then, along with Senator Dixon of Illinois, my cochair on the Northeast-Midwest Senate Coalition, hearings were held in Washington this year in January and February. I held the sixth hearing yesterday, and again in Pittsburgh. As a result of those hearings, I am convinced that it would be strongly contrary to the national interest to proceed with the proposed sale of Conrail to Norfolk Southern.

The best starting point on this issue is to deal with an article published by the distinguished Secretary of Transportation, Elizabeth Dole, in the New York Times the day before yesterday, Sunday, February 17.

I applaud Secretary Dole on her sincerity. But I must disagree with her both on her analysis of the facts, and on her conclusions as to what is best for the United States.

In the New York Times article Secretary Dole refers to a review of the Norfolk Southern by the Department of Justice, and she concludes that there will be preservation of competition in the region now served by Conrail.

My analysis of the facts convinces me that exactly the contrary is the case.

Today these two carriers, Conrail and Norfolk Southern, compete and have over 1,200 miles of parallel trackage throughout their systems.

The proposed sale would combine the current 18,000 miles of Norfolk Southern with 15,000 miles of Conrail and would have a very serious anticompetitive impact on the entire Nation.

The magnitude of the threat to competition is apparent when one considers that the combined rail system would have approximately 60 percent of the rail market in Michigan, 95 percent of the market in northeast Indiana, 70 percent of the southern Michigan steel traffic, 85 percent of the Cleveland grain traffic, and 94 percent of the eastbound New England-New York-Texas corridor rail traffic.

In fact, the Department of Justice itself in its January 29 report noted that the merger of Norfolk Southern and Conrail will have a "very serious anticompetitive effect."

It is apparent on the face of the Justice Department letter that Justice was straining to find some way to approve what the Secretary of Transportation wanted to accomplish. The final arbiter on the use of compliance with the antitrust laws, however, is obviously not the Department of Justice, but the courts. I submit that lawsuits which have already been promised by the Chessie Railroad at hearings held by the Northeast-Midwest coalition, will result in a round of litigation that will last a decade. The eventual conclusion will be to ban this proposed sale of Conrail to Norfolk Southern on the ground that it would violate the antitrust laws.

The Department of Justice further outlined the fact that there would be anticompetitive effects in 100 markets, and in 21 States. The Justice considerations ignored the impact on the area east of Buffalo, Harrisburg, and Philadelphia, and further ignored the antitrust problem which would be magnified by the consequences of abandonment of lines by the CSX Corp. On the basis of the existing facts, there is, therefore, no question about a violation of the antitrust laws.

The second point that Secretary Dole makes is one relating, as she points out in this New York Times article, to the best way to preserve service to Conrail shippers.

The conclusive evidence presented at the hearings which I have referred to discloses that there would be an adverse impact on shippers throughout the area served by Conrail within the Northeast-Midwest region.

Testimony, for example, by John Westhouse, the director of traffic for National Steel, disclosed that in 12 markets in which National Steel now ships where competition presently exists between Conrail and Norfolk Southern, such competition would be obliterated, thus raising prices for National Steel.

Similar testimony was given by Robert Corcoran, director of traffic for the United States Steel Corp.

I suggest, Mr. President, that it would be very harmful to add to the substantial costs which the American

[Exhibit A-1]

steel industry has already sustained in its battle to compete with foreign imports.

Testimony by many other shippers, including PPG, Fort Pitt Consolidators, and Consolidation Coal, disclosed that they now benefit from the competition of Conrail and Norfolk Southern, and that such petition would be eliminated by the proposed merger.

Throughout the corridor presently served by Conrail, such disastrous effects upon shippers, especially small shippers, would result, thereby adding to the cost of goods sold, impacting upon consumers, and causing a very severe inflationary impact.

The next issue involves the assertion by Secretary Dole that the "public should gain the best possible return on its investment" by a sale of Conrail to Norfolk Southern.

Mr. President, a return to the taxpayers of $1.2 billion for 85 percent of the stock of Conrail is a very small price considering the following facts.

First, the taxpayers have expended $7 billion on Conrail. Second, the book value of Conrail is in excess of $4 billion at the present time. We have yet not had an itemization of the assets of Conrail, notwithstanding my request to Secretary Dole which has been pending since August of 1984. At the present time, Conrail has $1.050 billion in cash—some $850 million in a cash reserve, and $200 million in excess funding for the pension plan which is really cash available to Conrail.

On the basis of these undisputed facts, Mr. President, I suggest that $1.2 billion for 85 percent of the stock is a grossly low price to be received by the taxpayers of the United States and the U.S. Government and that, in any event, such a low price should preclude any sale at this time. The bidding may be reopened and bids at a later date should not be hard to obtain, considering the fact that Conrail is currently earning profits of $500 million a year. Even without the tax breaks which Conrail presently receives as a governmental entity it would earn in the range of $230 million a year.

Secretary Dole further asserts in her New York Times article that the Conrail employees deserve to know what they futures hold. This assertion suggests that Conrail employees would be protected by the proposed sale to Norfolk Southern. The contrary is the fact. Norfolk Southern, in a press conference held last week, conceded that at least 2,500 employees would lose their jobs, and the estimates are that many times that number would in fact lose their employment.

The Secretary of Transportation further asserts that Conrail's Philadelphia offices would be maintained. Such an assertion seems fine, but there is no specification of the time period, and it is obviously inevitable that Norfolk Southern headquartered in Norfolk, VA, would abandon the Philadelphia, PA, offices.

One factor not considered by the Secretary of Transportation is of enormous importance to this Nation, and that is the competition offered by the port of Philadelphia to the port of Norfolk. If Norfolk Southern acquires Conrail, it will be only a short time before rail traffic will be diverted from the port of Philadelphia—notwithstanding the enormous investments made in that port to handle coal, and notwithstanding the absence of competitive benefits which run to the shippers now able to choose between ports through which to send their coal and their other products.

I do agree with one assertion in Secretary Dole's article, and that is the statement that an acquisition by Norfolk Southern would provide long-term stability for the Conrail system. Mr. President, I submit that the best way to provide maximum stability for the rail system in this country is to have one rail owner. But that is hardly the preferable course for this country, which thrives on competition. Further, it is too high a price to pay for stability to eliminate the competition which now benefits so many shippers throughout the areas now served by Conrail.

Mr. President, as to the issue of price, persuasive testimony has been adduced by investment bankers at Morgan Stanley that a public sale would yield $300 to $400 million more than the $1.2 billion offered by Norfolk Southern. On the basis of this record, it is my conclusion that the national interest would be best served by not selling Conrail at all at this time.

I do agree as a matter of philosophy that it is desirable ultimately to return Conrail to the private sector because, over the long term, a government held railroad should not exist and compete with private railroads. But on its face, given the sale price of $1.2 billion—which is totally inadequate according to the facts at hand—no sale would be the best alternative at the present time. If that fails, Mr. President, then I urge that the best alternative, considering the necessity for a sale, would be a public offering which would return the stock of Conrail to the American people and would, according to a very reliable estimate, yield $300 to $400 million more than the price is being offered by Norfolk Southern.

Mr. President, I make this statement today at some length because I think it is vitally necessary that the Senate of the United States focus on this issue at this time. Some suggestion has been made about folding the Conrail sale into the budget resolution, which I strongly oppose. But this matter will soon be before this body on one day or another. These facts are matters of great importance which far transcend the cataclysmic consequences to the State of Pennsylvania in terms of the loss of corporate headquarters, the loss of the repair yards in Hollidaysburg near Altoona and the impact on some 15,000 employees and 2,300 shippers. It is not in the national interest to sell Conrail to Norfolk Southern.

Mr. President, I ask unanimous consent that the text of the two bills that I am introducing today be printed in the Record.

There being no objection, the bills were ordered to be printed in the Record, as follows:

S. 484

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Congress finds that—

(1) the United States has invested more than $7,000,000,000 in the Consolidated Rail Corporation since April 1, 1976;

(2) the Consolidated Rail Corporation generated over $500,000,000 in profits in 1984;

(3) the Consolidated Rail Corporation has a book value in excess of $4,000,000,000;

(4) the Consolidated Rail Corporation has cash assets in excess of $1,000,000,000; and

(5) the United States Railway Association has determined that the Consolidated Rail Corporation is a profitable carrier as defined in section 403(a)(2) of the Regional Rail Reorganization Act of 1973 (45 U.S.C. 763(a)(2)).

Sec. 2. (a) Notwithstanding any provision of law, the Secretary of Transportation may not enter into any agreement with the Norfolk Southern Corporation for the sale of the Consolidated Rail Corporation.

(b) Notwithstanding any provision of law, any proposed agreement between the Secretary of Transportation and the Norfolk Southern Corporation for the sale of the Consolidated Rail Corporation, existing before or on the date of enactment of this Act, is hereby declared null and void.

S. 485

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled, That the Congress finds that—

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(4) the Consolidated Rail Corporation has cash assets in excess of $1,000,000,000; and

(5) the United States Railway Association has determined that the Consolidated Rail Corporation is a profitable carrier as defined in section 403(a)(2) of the Regional Rail Reorganization Act of 1973 (45 U.S.C. 763(a)(2)).

Sec. 2. (a) Notwithstanding any provision of law, any disposition of the government's interest in the Consolidated Rail Corporation shall proceed by public stock offering, and not by private sale.

[EXHIBIT A-2]

THE STAGGERS ACT: Good for Coal

Testimony of James V. Scahill, Executive Vice-President

Pennsylvania Coal Mining Association

before the

Subcommittee on Surface Transportation

Committee on Commerce, and Transportation

United States Senate

July 26, 1983

[EXHIBIT B]

Gentlemen:

I am James Scahill, Executive Vice-President of the Pennsylvania Coal Mining Association (PCMA). PCMA is a trade association of 160 coal companies and over 100 related service & supply companies, who collectively represent over 80% of the surface-mined production of Pennsylvania coal. One of our member companies is here today to testify. Bradford Coal Company will give detailed descriptions of its individual experience with the Staggers Act of 1980 and the effect it has had on the company. The intent of the Association's statement is to give you a broad overview of the current effect of the Act on Pennsylvania surface coal producers.

The Staggers Act of 1980, while short of wholesale deregulation, nevertheless substantially eased the regulatory burden on the railroad industry, providing significant changes in rules governing rate making, car control and other areas of railroading. Historically, the coal industry has depended upon the railroads for the bulk of the transportation of its product. The Staggers Act was welcomed by the entire coal industry in 1980 as a method to force competitiveness among railroads. After only one and one-half years of deregulation, many in our industry advocate opening of the Act. PCMA disagrees with that position for we believe that the full impact of the Staggers Act has yet to be felt. The entire coal industry is experiencing a depressed, buyer-oriented market. PCMA believes we should allow the Act to remain unchanged until it has had the opportunity to work in normal competitive markets. To us, the ones complaining about rates under the Staggers Act are those afraid of change and are also afraid to compete in an open market. Many of these changes have brought unfamiliar results.

Pennsylvania is served by a total of eleven railroads: CONRAIL, the Chessie System, Bessemer & Lake Erie, Cambria & Indiana, Delaware & Hudson, Lake Erie Franklin & Clarion, Monongahela, Montour, Norfolk & Western, Pittsburgh & Lake Erie, and the Pittsburgh & Shawm The bituminous coal industry in Pennsylvania is served mainly by CONRAI and to a lesser extent, the Chessie System and some of the smaller regional railroads. It is important to note that most of our operators in the Association are classified as captive shippers and that our operators' experience with the results of the Staggers Act has been generally favorable.

Deregulation through the Staggers Act has brought about a keen competitive environment that shippers have found refreshing. For the first time in many years, our shippers can truly negotiate contracts with the railroads on a competitive basis. As mentioned, railroads were restric far more than many other enterprises by regulations concerning their business practices and day-to-day management. The Staggers Act altered some of these restrictions and returned decision-making back to management. One of the key facets of this movement has been in the accounting field where the railroads have been placed on a "cost-plus" basis. This change has also assisted in establishing competition among the rail lines.

For purpose of further discussion, we will testify mainly about our relationship with CONRAIL since it is the major line with which we deal.

Perhaps the most extensive changes are in the provisions for rate making. While protection for rail-dependent shippers was retaine it was the intent of Congress that the disciplines of the competitive marketplace control most rate making. The new rate provisions curtail activities of rate bureaus and phase out general rate increases, while offering flexibility in setting rates. In the past, the coal industry was hampered by rail rates that could take up to two years to change; therefore, changes in the overall delivered price of coal that changed in the marketplace were totally absorbed by the shipper. Today, changes in rail rates can be accomplished in a matter of days to reflec changes in overall prices of coal.

The only problem that has surfaced has been in the area of joint and combination rates. A "Joint Rate" is a single price charged for th movement of a shipment via two or more railroads. A "Combination (or Proportional) Rate" is the price for movement over two or more railroads resulting from the addition of the separate price of the individual railroads. Due to the maneuvering of the largest carriers, CONRAIL has cancelled joint rates for the majority of its interline traffic. This has caused a hardship on the smaller regional railroads within the CONRAIL system. Under the combination rate, one of our regional Class III railroads, the Pittsburgh & Shawmut, is forced to charge a rate above the competitive rate to ensure P & S profitability. *(See Attachment "A")* It must be emphasized that this problem of rates is between CONRAIL and the regional lines, not because of the Staggers Act.

Another benefit of the Staggers Act can be seen in the modernization of loading facilities. Shippers can receive special reduced rates if they can show a reduction in CONRAIL'S cost, thereby providing incentives for shippers to modernize their facilities. In the past, modernization of loading facilities meant nothing in relationship to the fixed rates - a shipper paid the same rate regardless of the efficiency of his operation.

On June 9, 1983, the Interstate Commerce Commission issued a decision to exempt from regulation coal shipped by rail for export. Again, many in the coal industry have argued that deregulation of export coal will be harmful to our industry due to increased rates and loss of coal sales to the world market. PCMA disagrees with that assessment due to the domestic competitiveness we have already witnessed. What has been good for the domestic market, i.e. increased competition, can only hold true in the export marketplace. In fact, deregulation of export coal will eliminate what has been the only regulated element in the total export coal marketing chain consisting of producers, transportation companies and coal consumers. This will require railroads to compete in the rate or price area - something they didn't have to do prior to Staggers, and will permit export coal shippers to effectively compete in foreign markets by tailoring rail transportation to their total delivery requirements. Delivered coal at a specific TOTAL cost has become a distinct requirement in the export market. All interests are encouraged to work together as equal partners in the marketing chain. Pennsylvania coal has been known as the "coal of last resort" in world markets. There are indications that the relative position of our coal, while still relatively small, is growing stronger. Much of the credit for Pennsylvania's growth must go to the partnership formed by our producers, state government and CONRAIL. Recently, CONRAIL renovated Pier 124 in Philadelphia to assure it has the physical capacity to participate in the growth of the export market. As an indication of the effect of Staggers, one should study the CONRAIL Export Rates from Clearfield (PA) District since the Act:

9/01/80	$13.06	10/01/81	$14.60
12/31/80	$13.71	1/01/82	$14.96
1/17/81	$13.82	3/14/82	$14.96
4/07/81	$14.09	10/11/82	$13.40
7/01/81	$14.40	7/01/83	$13.40

In October of 1982, CONRAIL guaranteed the rate until January of 1984. CONRAIL has also initiated several other competitive marketing efforts, including:

WEST VIRGINIA STRATEGY: CONRAIL has reduced rates fo low-sulfur West Virginia coal being shippe to Pier 124 to encourage blending with higher sulfur Pennsylvania coal to make the PA coal more suitable to export markets. *(See Attachment "B")*

LINE REHABILITATION: In 1982 CONRAIL spent $ 9.8 millio and in 1983 spent $ 7 million to improve its coal hauling routes in central and western Pennsylvania.

LOADING GUARANTEES: CONRAIL guarantees to load vessels at Pier 124 at a rate of 15,000 tons per 24 hours or pay a vessel detention fee to the shipper. *(See Attachment "C")*

It is the Pennsylvania Coal Mining Association's belief that CONRAIL is making an earnest effort to become competitive in both the domestic and export marketplace. That initiative has come about due to the enactment of the Staggers Act of 1980. By allowing the railroads to price competitively and to reduce their rates on low cost routes to meet the competition, their revenues can be increased without raising rates. We ask that the Staggers Act of 1980 be allowed to stand on its own merit until such time that change is needed.

Thank you.

Revenue Freight Handled and Revenue Received
Class I Railroads

Year	Revenue Freight Originated: Coal (1,000 Net Tons)	Revenue Freight Originated: All Commodities (1,000 Net Tons)	Revenue Freight Originated: Coal as % of All Commodities (Percent)	Revenue Received: Coal ($1,000)	Revenue Received: All Commodities ($1,000)	Revenue Received: Coal as % of All Commodities (Percent)
1963	331,667	1,284,848	25.8	1,065,194	8,559,454	12.4
1964	344,970	1,354,612	25.5	1,072,034	8,907,780	12.0
1965	352,597	1,387,423	25.4	1,102,266	9,276,393	11.9
1966	367,506	1,448,901	25.4	1,110,536	9,719,395	11.4
1967	376,704	1,407,628	26.8	1,130,226	9,530,300	11.9
1968	371,654	1,431,346	26.0	1,117,158	10,209,768	10.9
1969	376,336	1,473,457	25.5	1,171,254	10,836,160	10.8
1970	398,830	1,484,161	26.9	1,361,950	11,366,446	12.0
1971	354,954	1,390,960	25.5	1,314,837	12,247,102	10.7
1972	371,135	1,447,864	25.6	1,361,206	13,012,996	10.5
1973	372,220	1,532,165	24.3	1,406,655	14,334,623	9.8
1974	387,704	1,530,585	25.3	1,826,029	16,369,081	11.2
1975	405,047	1,392,363	29.1	2,127,722	15,867,698	13.4
1976	405,169	1,406,748	28.8	2,374,032	17,935,514	13.2
1977	412,828	1,393,145	29.6	2,677,019	19,358,529	13.8
1978	381,211	1,389,625	27.4	2,791,740	20,760,540	13.4
1979	510,179	1,407,914	36.2	3,894,976	27,764,726	14.0
1980	522,071	1,492,414	35.0	4,955,635	26,937,685	18.4
1981	527,649	1,453,022	36.3	5,976,595	29,589,895	20.2
1982	523,823	1,268,645	41.0	6,307,038	26,503,882	23.8
1983	493,610	1,292,607	38.2	5,969,167	26,709,999	22.4

NOTE: Prior to January 1, 1956, the Interstate Commerce Commission classified the railroad operating companies with annual operating revenues over $1 million as Class I railroads. Effective January 1, 1956, railroads were reclassified so that Class I railroads were those having annual operating revenues of $3 million or more. The base for Class I railroads was raised to $5 million effective January 1, 1965, to $10 million effective January 1, 1976 and to $50 million effective January 1, 1978.

SOURCE: Interstate Commerce Commission; Freight Commodity Statistics.

Average Revenue per Ton for Hauling Coal[1]
Class I Railroads

Year	Eastern District	Southern District	Western District	Total U.S.
1973	4.42	2.66	3.62	3.79
1974	5.50	3.31	4.59	4.71
1975	6.07	3.65	5.37	5.25
1976	6.92	4.02	5.84	5.86
1977	7.22	4.78	6.99	6.48
1978	7.92	5.23	8.34	7.32
1979	8.89	5.89	9.11	8.22
1980	10.44	6.79	10.29	9.49
1981	12.15	8.26	12.59	11.33
1982	12.87	8.43	13.56	12.34
1983	12.48	8.20	14.21	12.09

[1] Prior to January 1, 1956, the Interstate Commerce Commission (ICC) classified the railroad operating companies with annual operating revenue over $1 million as Class I railroads. Effective January 1, 1956, railroads were reclassified so that Class I railroads were those having annual operating revenues of $3 million or more. The base for Class I railroads was raised to $5 million effective January 1, 1965, to $10 million effective January 1, 1976 and to $50 million effective January 1, 1978.

NOTE: Data for average revenue per ton are derived simply from taking total revenue received by railroads for hauling coal, dividing by total tonnages originated, as reported in ICC Commodity Statistics. They indicate the trend only.

SOURCE: Interstate Commerce Commission; Freight Commodity Statistics.

[EXHIBIT C]

Coal Handled and Revenue Received as Percent of Total Railroad Freight by Major Coal Carrying Railroads

1982

Railroads	Revenue Freight			Freight Revenue		
	Coal Originated (1,000 Tons)	All Commodities (1,000 Tons)	Coal as % of All Commodities	Coal ($1,000)	All Commodities ($1,000)	Coal as % of All Commodities
Eastern District						
Baltimore & Ohio	25,362	44,855	56.5	327,270	931,475	35.1
Bessemer & Lake Erie	7,012	7,712	90.9	61,485	80,944	76.0
Chesapeake & Ohio	60,507	73,223	82.6	686,631	1,102,111	66.9
Conrail	33,766	96,840	34.9	527,888	2,918,206	18.1
Elgin, Joliet & Eastern	27	5,205	0.5	19,777	56,059	35.3
Norfolk & Western	75,454	105,271	71.7	962,583	1,672,707	57.5
Pittsburgh & Lake Erie	156	3,972	3.9	20,583	51,979	39.6
Western Maryland	7,524	9,021	83.4	59,846	83,655	71.5
Southern District						
Clinchfield	9,190	10,181	90.3	77,917	103,081	75.6
Illinois Central Gulf	21,879	57,614	38.0	132,725	838,204	15.8
Louisville & Nashville	55,823	81,924	68.1	415,541	1,121,515	37.1
Seaboard Coast Line	6	80,779	0.0	130,264	1,158,339	11.2
Southern System	40,111	99,752	40.2	313,529	1,603,672	19.6
Western District						
Atchison, Topeka & Santa Fe	8,335	64,765	12.9	187,402	2,137,812	8.8
Burlington Northern	117,961	197,429	59.7	1,394,336	3,806,172	36.6
Chicago & North Western	1,774	33,086	5.4	88,402	724,583	12.2
Denver, Rio Grande & Western	18,842	22,546	83.6	138,636	298,866	46.4
Duluth, Missabe & Iron Range	39	27,670	0.1	253	50,479	0.5
Kansas City Southern	2,952	13,734	21.5	76,657	302,941	25.3
Milwaukee Railroad	3,185	14,442	22.1	36,575	352,205	10.4
Missouri-Kansas-Texas	136	5,440	2.5	36,779	231,677	15.9
Missouri Pacific	19,699	69,622	28.3	225,226	1,710,523	13.2
Soo Line	47	8,210	0.6	3,692	292,980	1.3
Southern Pacific	14	53,640	0.0	55,406	2,009,554	2.8
Union Pacific	14,017	54,000	26.0	284,936	1,783,975	16.0

1983

Railroads	Revenue Freight			Freight Revenue		
	Coal Originated (1,000 Tons)	All Commodities (1,000 Tons)	Coal as % of All Commodities	Coal ($1,000)	All Commodities ($1,000)	Coal as % of All Commodities
Eastern District						
Baltimore & Ohio	22,866	46,032	49.7	270,735	944,306	28.7
Bessemer & Lake Erie	6,041	7,137	84.6	43,337	64,194	67.5
Chesapeake & Ohio	55,425	69,820	79.4	599,942	962,204	62.4
Conrail	31,599	101,556	31.1	486,493	2,952,141	16.5
Elgin, Joliet & Eastern	142	5,737	2.5	20,066	59,721	33.6
Norfolk & Western	63,273	96,192	65.8	788,430	1,513,423	52.1
Pittsburgh & Lake Erie	127	4,262	3.0	15,361	48,482	31.7
Western Maryland	4,367	5,407	80.8	39,650	50,248	78.9
Southern District						
Illinois Central Gulf	20,948	57,829	36.2	128,270	816,235	15.7
Seaboard Coast Line 1/	62,179	183,750	33.8	573,819	2,487,108	23.1
Southern Systems	37,626	97,811	38.5	286,137	1,600,024	17.9
Western District						
Atchison, Topeka & Santa Fe	6,680	58,691	11.4	174,661	2,095,917	8.3
Burlington Northern	124,697	213,026	58.5	1,577,271	4,046,864	39.0
Milwaukee Railroad	2,245	14,712	15.3	38,293	386,510	9.9
Chicago & North Western	2,486	41,883	5.9	90,588	812,573	11.1
Denver, Rio Grande & Western	14,627	18,466	79.2	129,845	317,179	40.9
Duluth, Missabe & Iron Range	57	27,572	0.2	332	75,978	0.4
Kansas City Southern	2,365	13,903	17.0	82,272	307,815	26.7
Missouri-Kansas-Texas	69	5,648	1.2	34,782	230,139	15.1
Missouri Pacific	22,228	72,939	30.5	220,910	1,664,907	13.3
Soo Line	2	8,701	0.0	4,202	299,241	1.4
Southern Pacific	2	52,962	0.0	52,539	1,989,758	2.6
Union Pacific	13,573	61,073	22.2	271,716	1,828,637	14.9

1/ Includes data for Clinchfield and Louisville & Nashville.

SOURCE: Interstate Commerce Commission; Freight Commodity Statistics.

[EXHIBIT C-2]

Average Coal Revenue Received by Class I Railroads

Railroads	1982 Total Carried (1,000 Tons)	1982 Gross Revenue Received ($1,000)	1982 Average Revenue Per Ton (Dollars)	1983 Total Carried (1,000 Tons)	1983 Gross Revenue Received ($1,000)	1983 Average Revenue Per Ton (Dollars)
Eastern District						
Baltimore & Ohio	41,619	327,270	7.86	36,448	270,735	7.43
Bessemer & Lake Erie	10,613	61,485	5.79	7,439	43,337	5.83
Boston & Maine	1,641	9,850	6.00	1,463	8,713	5.96
Chesapeake & Ohio	69,994	686,631	9.81	65,192	599,942	9.20
Conrail	66,788	527,888	7.90	62,883	486,493	7.74
Delaware & Hudson	235	2,115	9.00	347	3,197	9.21
Detroit, Toledo & Ironton	1,669	11,855	7.10	1,147	9,715	8.47
Elgin, Joliet & Eastern	5,679	19,777	3.48	5,870	20,066	3.42
Grand Trunk Western	1,692	11,089	6.55	1,527	11,242	7.36
Long Island	58	342	5.90	-	-	-
Norfolk & Western	83,942	962,583	11.47	72,254	788,430	10.91
Pittsburgh & Lake Erie	7,488	20,583	2.75	6,092	15,361	2.52
Western Maryland	10,154	59,846	5.89	7,328	36,650	5.00
Southern District						
Clinchfield	20,846	77,917	3.74	-	-	- 1/
Florida East Coast	81	907	11.20	132	1,457	11.04
Illinois Central Gulf	27,540	132,725	4.82	25,099	128,270	5.11
Louisville & Nashville	57,819	415,541	7.19	-	-	- 1/
Seaboard Coast Line	25,904	130,264	5.03	73,537	573,819	7.80
Southern System	47,010	313,529	6.67	43,322	286,136	6.60
Western District						
Atchison, Topeka & Santa Fe	24,308	187,402	7.71	25,644	174,661	6.81
Burlington Northern	123,893	1,394,336	11.25	129,163	1,577,271	12.21
Chicago & North Western	16,090	88,402	5.49	16,360	90,586	5.54
Denver, Rio Grande & Western	19,474	13[illegible]36	7.12	14,654	129,845	8.86
Duluth, Missabe & Iron Range	65	253	3.89	57	332	5.82
Kansas City Southern	12,725	76,657	6.02	13,186	82,272	6.24
Milwaukee Railroad	7,712	36,575	4.74	7,686	38,293	4.98
Missouri-Kansas-Texas	6,345	36,779	5.80	5,991	34,782	5.81
Missouri Pacific	37,395	225,226	6.02	40,353	220,910	5.47
St. Louis Southwestern	17	86	5.06	7	83	11.86
Soo Line	500	3,692	7.38	491	4,202	8.56
Southern Pacific	7,352	55,406	7.54	6,697	52,539	7.85
Union Pacific	26,602	284,936	10.71	25,001	271,716	10.87
Western Pacific	807	6,457	8.00	898	8,111	9.03

1/ Included with Seaboard Coast Line.

NOTE: Average revenue is derived from taking total coal revenue received, dividing by total tonnages carried. Data indicate the trend only.

SOURCE: Interstate Commerce Commission; Freight Commodity Statistics.

[EXHIBIT C-3]

Coal Handled by Class I Railroads[1]

1983

Railroads	Revenue Freight Originated 2/		Revenue Freight Terminated 3/		Total Freight 4/		Gross Revenue (Dollars)
	Carloads	Tons	Carloads	Tons	Carloads	Tons	
astern District							
altimore & Ohio	261,354	22,865,644	293,863	24,764,839	444,709	36,447,933	$ 270,734,581
essemer & Lake Erie	66,978	6,040,865	6,289	570,176	82,230	7,439,347	43,337,064
ston & Maine	6	434	14,597	1,376,200	15,721	1,462,808	8,713,113
esapeake & Ohio	635,451	55,425,193	338,108	30,290,124	748,814	65,191,540	599,941,931
nrail	335,451	31,599,063	609,369	56,255,541	678,764	62,882,842	486,492,802
laware & Hudson	22	1,583	898	76,466	4,205	347,285	3,196,795
troit, Toledo & Ironton	0	0	8,184	1,089,026	10,425	1,147,319	9,715,174
gin, Joliet & Eastern	1,412	142,387	61,372	5,870,071	61,373	5,870,153	20,066,023
and Trunk Western	2	147	19,143	1,470,495	19,890	1,527,056	11,241,652
rfolk & Western	675,357	63,273,257	551,538	51,928,696	771,106	72,254,485	798,430,496
tsburgh & Lake Erie	1,461	127,377	9,669	875,825	59,544	6,092,159	15,361,196
estern Maryland	58,721	4,367,100	14,924	982,246	95,790	7,327,602	36,650,456
District Total	2,056,215	183,843,050	1,927,954	175,549,705	2,992,571	267,990,529	$2,293,881,283
uthern District							
lorida East Coast	0	0	1,604	131,770	1,604	131,770	$ 1,456,756
llinois Central Gulf	215,575	20,947,836	174,859	16,955,727	259,686	25,098,814	128,269,533
eaboard Coast Line	673,758	62,178,691	602,582	56,177,284	900,069	73,537,241	573,818,762
uthern Railroad	395,119	37,626,479	409,876	38,861,041	459,648	43,321,703	286,136,413
District Total	611,367	120,753,006	1,188,921	112,125,822	1,521,007	142,089,528	$ 989,681,464
estern District							
chison, Topeka & Santa Fe	68,779	6,679,864	222,632	22,172,342	257,909	25,643,785	$ 174,660,717
rlington Northern	1,268,714	124,679,164	560,754	54,422,891	1,315,057	129,163,129	1,577,270,968
icago & North Western	24,764	2,485,769	113,045	11,074,804	167,844	16,359,954	90,587,982
nver, Rio Grande & Western	151,683	14,626,934	56,658	5,526,490	152,020	14,654,245	129,844,908
uth, Missabe & Iron Range	778	56,642	778	56,642	778	56,642	331,674
nsas City Southern	23,603	2,365,134	133,454	13,154,267	133,785	13,185,982	82,272,278
lwaukee Railroad	27,078	2,245,399	73,227	6,781,749	82,222	7,685,574	38,292,500
issouri-Kansas-Texas	722	69,340	60,946	5,920,465	61,676	5,991,255	34,782,211
issouri Pacific	225,769	22,228,457	317,805	31,190,641	410,974	40,352,601	220,910,466
Louis Southwestern	0	0	0	0	104	7,007	82,700
Soo Line	31	1,912	3,521	319,310	5,388	490,974	4,201,570
uthern Pacific	40	2,283	67,113	6,370,280	70,513	6,696,672	52,538,743
ion Pacific	142,971	13,572,850	144,274	14,007,562	260,456	25,000,566	271,715,939
estern Pacific	0	0	9,779	897,709	9,789	898,483	8,111,419
District Total	1,934,932	189,013,748	1,763,986	171,895,153	2,928,515	286,186,889	$2,685,604,075
nited States Total	4,602,514	493,609,804	4,880,861	459,570,680	7,442,093	696,266,946	$5,969,166,822

1/ Includes bituminous, anthracite, and lignite.
2/ Revenue Freight Originated = The sum of freight originated and terminated and freight originated and delivered to another carrier.
3/ Revenue Freight Terminated = The sum of freight originated and terminated and freight received and terminated.
4/ Total Freight = The sum of revenue freight originated and terminated, originated and delivered to another carrier, received and terminated, and received and delivered to another carrier.

SOURCE: Interstate Commerce Commission; Freight Commodity Statistics.

[EXHIBIT C-4]

Attachment "A"

Summary of Interim Conrail Joint Rate, Switching Actions

Conrail cancelled joint rates, effective February 26, 1983, where Conrail reaches origin and destination, except for GTW and DTI.

To protect Conrail line haul traffic from diversion as a result of switching cancellations by other carriers, Conrail has made a limited number of 45-day commodity, location specific exceptions from rate cancellations.

Conrail has also implemented a $187 per car allowance to be paid to any shipper who is required, as a result of switching cancellations by other railroads, to pay a separate commercial switch charge to reach Conrail.

Effective February 19, 1983, Conrail established a minimum commercial switching fee of $358 for railroad-owned cars.

Effective March 19, 1983, Conrail will establish a minimum commercial switching fee of $280 for private cars.

Also effective March 19, 1983, Conrail has filed for an increase on its reciprocal switching charges to other carriers to $280 per car from $187 per car.

Also effective March 19, 1983, Conrail has filed to cancel reciprocal switching on paper and coal for account of CSX and NWS. These are the two principal commodities on which Conrail's routing has been cancelled.

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[EXHIBIT D]

Attachment "B"

WEST VIRGINIA COAL STRATEGY ANNOUNCEMENT

In order to increase throughput at the modernized Pier 124, to increase Conrail and Pennsylvania Coal's participation in lower-sulphur coal markets, and to strengthen the production capacity of Conrail-local mines, Conrail is announcing a new strategy for West Virginia Coal Exports designed to achieve the objectives.

Conrail will publish a tariff designed to draw cargoes of expor coal from its Kanawha and New River Districts to Pier 124 in Philadelphia. Provisions of this tariff will include:

TRAINLOAD RATES: ANNUAL TONNAGE LEVELS	$15.90/net ton - Applies on first 150,000 to $15.40/net ton - Applies on next 150,000 to $14.40/net ton - Applies on tonnage in exces of 300,000 tons
SHIPMENT SIZE:	Minimum of 7,000 tons, maximum of 8,000 tons
ORIGINS:	Maximum of three origins from Conrail Kanawh and New River Districts loaded on one date a served from the same serving yard
PERMITTING:	10 days for loading cargo for vessels 55,000 DWT capacity or larger 5 days for loading cargo for less than 55,0 DWT vessel
RATE ADJUSTMENT:	Standard tariff adjustments
DEMURRAGE:	Twenty-four hours free time at origin with demurrage of $20.00 per car per day or fract thereof beyond free time - Standard tidewater demurrage at Pier 124
LESS THAN TRAINLOAD RATE:	$18.40/net ton - Shipment Size: Less than trainload (LTTL) - Origins: Kanawha and New River Districts - Permitting: Standard permit periods - Adjustment: Standard tariff rate adjustments - Demurrage: Standard LTTL demurrage at origin; Standard tidewater demurra at Pier 124
EQUIPMENT:	Conrail open top hoppers
DURATION:	Tariff will be effective for two years

[EXHIBIT D-2]

NOTE: One party must be designated as the transshipper responsible for coordination of shipment permits and freight charges for all cargoes involving the movement of Kanawha Valley Coal under the volume rates quoted above. Conrail makes this requirement in order to avoid the high cost of record-keeping, which would otherwise be associated with monitoring the volume requirements of this tariff.

Conrail is also offering two options for accounts interested in contracting for transportation service to Pier 124, either of whic produces considerable savings. The differences between the two options are in the level of volume commitment, and penalty for volume shortfall, with other terms the same. The basic contract terms are:

TRAINLOAD RATES, VOLUME, AND PENALTY:

Option 1: $15.40 per net ton, 300,000 ton minimum annual commitment
$14.40 per net ton applies on tonnage over 300,000 ton annual level.
Penalty - 25% of base rate on annual tonnage shortfall

Option 2: $14.40 per net ton, 500,000 ton minimum annual commitment
Penalty - 30% of base rate on annual tonnage shortfall

SHIPMENT SIZE: Minimum 7,000 tons, maximum 8,000 tons

ORIGINS: Maximum of two origins from Conrail's Kanawha and New River Districts loaded on one date and served from the same serving yard

PERMITTING: 10 days for vessels 55,000 DWT Or larger
6 days for vessels less than 55,000 DWT

RATE ADJUSTMENTS: Quarterly RCRI increases and/or reductions

DEMURRAGE:
- o Twenty-four hours free time to load at origin with demurrage of $20.00 per car per day or fraction thereof beyond free time
- o Standard tidewater demurrage at Pier 124

TERM: Two years

EQUIPMENT: Conrail open top hoppers

Conrail is also taking another action to achieve the objectives stated earlier. This thrust offers incentives for blending West Virginia coal with higher-sulphur Pennsylvania coals served by

[EXHIBIT D-3]

Conrail to produce a mixture with sulphur content low enough to compete in compliance coal markets overseas. These incentives ta the form of rate reductions on a vessel-by-vessel basis, and are offered when the proportion of West Virginia coal loaded in a particular vessel is between 30% and 65%, inclusive. The amount this reduction is defined by an equation given below, and result in a maximum reduction from the rates quoted above of $1.00 per ton when 30% West Virginia coal is used, and a minimum of $.46 p net ton when 65% West Virginia coal is blended with Pennsylvania origin coal served by Conrail. These rate reductions will be afforded on all trainload and single car rates listed above, including those involving contract offers. The equation is:

$$Y = -1.54\ (X) + 1.46$$

Where:

X = Proportion of West Virginia coal included in the blend

Y = Rate reduction (dollars per net ton) on the West Virgini tonnage included in the cargo loaded into the vessel at Pier 124

X = 50%

$$-1.54 \times .50 = -.77$$
$$\underline{+1.46}$$

69¢ refund

[EXHIBIT D-4]

G-4 85 1

MEMORANDUM

CONRAIL

TO Distribution

DATE June 14, 1983

FROM R. C. Burlando RCB

450 6 Penn Center

Phila., PA 19104

SUBJECT West Virginia to Pier 124 Export Reductions

PHONE

This is to advise you that Conrail has reduced its West Virginia to Pier 124 export coal rates effective June 5, 1983, and increased the attractiveness of these rates by reducing the volume threshhold required for incentive rates.

Recall that the original tariff included the following rate and volume provisions:

VOLUME	APPLICABLE RATE (TL)
First 150,000 NT	$15.90/NT
Next 150,000 NT	15.40/NT
Over 300,000 NT	14.40/NT

Since that time, N+W contracts tied to a declining RCRI have lowered the N+W competitive price, and the Chessie has entered refund-for-volum contracts. Thus, our base rate had become uncompetitive. To regain our price leadership position, we made the following change in Supplement 4 to Tariff 4806, effective June 5, 1983:

VOLUME	APPLICABLE RATE (TL)
First 100,000NT (1983)	$15.00/NT
Over 100,000NT (1983)	14.40/NT
First 300,000NT (after 1983)	15.00/NT
Over 300,000NT (after 1983)	14.40/NT

Other provisions of the tariff, such as the allowance for blending with Pennsylvania coal, remain the same.

The result of this reduction is that Conrail is about $.40/NT cheaper than its competitors for movements of southern West Virginia coal for export. Please keep this fact in mind when dealing with brokers and traders, consumers of low sulphur coal, and producers located on Conrail or NF&G in southern West Virginia.

RCB/aat

[EXHIBIT D-5]

NEWS CONRAIL

Attachment "C"

FOR RELEASE: April 26, 1983

CONTACT: Saul Resnick
Patricia Illuminati
(215) 977-4594

Conrail Guarantees Coal Loadings -- Or Will Pay Detention Fee

PHILADELPHIA -- Continuing its efforts to encourage the movement of export coal through the recently renovated Pier 124 in South Philadelphia, Consolidated Rail Corporation announced that it is guaranteeing to load vessels at an average rate of 15,000 tons per 24-hour period -- or pay a vessel detention fee of $335 per hour, subject to certain limitations. The guarantee is effective today.

Pier 124 is the first railroad-operated coal loading facility in the United States to offer this guarantee, which is effective until October 1, 1983.

Under the guarantee, for example, a vessel taking on 60,000 tons of coal would be loaded within 96 hours. If the vessel-loading process took more than 96 hours, Conrail would pay $335 to the shipper for each full hour of delay, up to certain limits.

"The guarantee is a further demonstration of Conrail's confidence in the dependability of the coal-handling operation at Pier 124," said Warren G. Barber, Conrail's assistant vice president-coal marketing. "And it is further evidence of our commitment to support the marketing of Pennsylvania coal." The coal-loading guarantee tariff containing all details was filed with the Interstate Commerce Commission earlier this month.

In the past year, Conrail has instituted a series of rate and service initiatives to encourage the movement of Pennsylvania coal

[EXHIBIT D-6]

CONSOLIDATED RAIL CORPORATION SIX PENN CENTER PLAZA, PHILADELPHIA, PA 19104 215-977-4

through the Philadelphia trans-loading facility. Examples of other rate initiatives include:

- In October 1982, Conrail rolled back to 1979 levels rates on Pennsylvania bituminous coal moving to Pier 124 for export. The bituminous rates are guaranteed until January 1, 1984. At the same time, Conrail also guaranteed to hold in place January 1982 rates on anthracite coal moving to Pier 124 for export until at least January 1, 1984.
- In September 1982, Conrail significantly reduced rates to Pier 124 for coal coming from the mines of Kanawha Valley, West Virginia. In early April, 1983 the first vessel to take on coal under those reduced West Virginia rates was fully loaded at Pier 124. It was also the first Panamax class vessel to load coal at Pier 124 and not top off elsewhere.

Since its inception April 1, 1976, Conrail has accomplished a massive rehabilitation of its coal-carrying lines:

- In 1982 alone, Conrail spent about $9.8 million to upgrade and improve its coal hauling routes in central and western Pennsylvania and eastern Ohio.
- From 1976 through 1982, Conrail has spent $79.2 million to upgrade its coal hauling branch lines in central and western Pennsylvania.
- In 1983, another $7 million worth of rehabilitation work is scheduled for this area.

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[EXHIBIT D-7]

The **Chairman**. Mr. Schleede.

STATEMENT OF GLENN R. SCHLEEDE

Mr. **Schleede**. Thank you, Mr. Chairman.

My name is Glenn Schleede. I work for the New England Electric system, which serves customers in 1.1 million homes, businesses and institutions in Massachusetts, Rhode Island, and New Hampshire.

I appreciate this opportunity to explain why the sale of Conrail to Norfolk Southern would sharply reduce competition and could lead to higher electric bills for customers in the New England region.

In very brief summary of our position, we urge you to oppose the sale of Conrail to Norfolk Southern. We favor ending Federal ownership of Conrail, but do not believe that our customers should bear the risks and the costs associated with the DOT proposal. Further, we doubt that situations such as ours have been considered adequately by the Departments of Transportation and Justice.

With that brief introduction, I would like to provide a few details on six points.

First, it is important to recognize that coal and the cost of hauling coal now have a significant impact on electric bills in New England.

Fuel costs make up 35 percent of our total cost of providing electricity. We have switched from being 78 percent dependent on oil in 1979 to only 25 percent this year. Coal now provides 50 percent of our energy. We converted six generating units from oil back to coal at a cost of nearly $300 million. This year, we will burn about 3.5 million tons of coal and avoid burning about 15 million barrels of foreign oil.

Within the United States, we can obtain coal meeting our needs from Pennsylvania, West Virginia, and Virginia. We move that coal via Conrail, Chessie, and Norfolk Southern's N&W Railroad, to Philadelphia, Baltimore, Newport News, and Norfolk. From there, we move the coal by ship and barge to our generating plans in New England. There are no rail connections to our plants.

Rail costs account for 25 percent of the total delivered cost of our coal. Coal at the mine is 65 percent, and ocean transport 10 percent. Fuel and fuel transport costs are, of course, paid for by electric customers. In fact, our customers are paying more than $40 million this year just for rail costs. That is more than $3 per month per customer.

The second point is that rail rates for hauling coal are excessive. There is no effective regulatory protection at present, and competition among railroads is the only hope for coal producers, coal users, and their electric customers, who have some competing alternatives available.

The third point I want to make is that competition among Eastern railroads—Norfolk Southern, Chessie, and Conrail—has begun to work to temper excessive rail rates for those shippers such as our company that have clear alternatives. We have begun to see competition and have gained some experience under rail contracts.

In theory, our ability to use three rail systems should have produced competition immediately after the Staggers Act passed, but we learned that contracts and rate relief do not come easily.

It took 2½ years after Staggers for us to get our first contract, 4 years for the second, and 4½ for the third, which was just last month. We have gotten some rate relief, but we do not believe we have yet achieved reasonable rates. We define reasonable rates as those which do not exceed a railroad's fully allocated cost of providing our rail services, including a fair return on equity.

I cannot reveal specific terms of our various contracts; but I can assure that the rates on Norfolk Southern's N&W Railroad are the highest we pay—whether measured in terms of dollars per ton, revenue to variable costs, or revenue to fully allocated costs.

Our conclusions are based on detailed cost data compiled by consultants who are experts in rail rate matters. These analyses make clear that rates charged by the N&W are well above fully allocated costs. In fact, we believe Norfolk Southern's return on equity from our coal movements is in excess of 48 percent before taxes and 26 percent after taxes.

The fourth point I want to make is that we are very concerned about the loss of competition provided by Conrail and the clear potential that we will be subjected to higher rates if Norfolk Southern is permitted to acquire Conrail and raise Conrail's rates.

In our case, the number of potential rail competitors shrink from three to two. Further, if Norfolk Southern's existing rate policies were extended to Conrail, our calculations indicate that we could expect rate increases for coal on Conrail of 20 to 25 percent, or between $2.25 and $2.75 per ton.

The fifth point I wish to make is that our situation apparently was not considered in the analyses of competition conducted by the Justice Department. As nearly as we can tell, Justice did not consider situations where coal is shipped from Appalachia to east coast ports for export or for coastwise shipment to other U.S. destinations. This appears to be a major weakness in the analysis.

The sixth and final point I wish to make is that there must be a better way of disposing of the Federal Government's interest in Conrail. We fully support the Reagan administration's objective of ending Federal ownership and regret having to oppose this alternative after such a long effort by DOT.

The **Chairman**. Thank you, Mr. Schleede.

[The following was received for the record:]

STATEMENT BY GLENN R. SCHLEEDE FOR THE COMMITTEE ON THE JUDICIARY OF THE U.S. SENATE -- HEARINGS ON THE ANTI-TRUST IMPLICATIONS OF THE SALE OF CONRAIL TO THE NORFOLK SOUTHERN CORPORATION

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

MY NAME IS GLENN SCHLEEDE. I WORK FOR THE NEW ENGLAND ELECTRIC SYSTEM (NEES), WHICH SERVES CUSTOMERS IN 1.1 MILLION HOMES, BUSINESSES AND INSTITUTIONS IN MASSACHUSETTS, RHODE ISLAND, AND NEW HAMPSHIRE.

SUMMARY

I APPRECIATE THIS OPPORTUNITY TO EXPLAIN WHY THE SALE OF CONRAIL TO NORFOLK SOUTHERN WOULD (I) SHARPLY REDUCE COMPETITION AND (II) LEAD TO HIGHER ELECTRIC BILLS FOR CUSTOMERS IN THE NEW ENGLAND REGION.

IN BRIEF SUMMARY, WE URGE YOU TO OPPOSE THE SALE OF CONRAIL TO NORFOLK SOUTHERN. WE FAVOR ENDING FEDERAL OWNERSHIP OF CONRAIL AND REGRET HAVING TO OPPOSE THE ALTERNATIVE SELECTED BY THE ADMINISTRATION. HOWEVER, WE DO NOT BELIEVE OUR CUSTOMERS SHOULD BEAR THE COSTS AND RISKS ASSOCIATED WITH THE PROPOSAL. FURTHER, WE DOUBT THAT SITUATIONS SUCH AS OURS HAVE BEEN CONSIDERED ADEQUATELY BY THE DEPARTMENTS OF JUSTICE AND TRANSPORTATION.

IN THE NEXT FEW MINUTES, I PLAN TO EXPLAIN WHY WE BELIEVE NORFOLK SOUTHERN SHOULD NOT BE ALLOWED TO ACQUIRE CONRAIL, INCLUDING:

- FIRST, THE IMPORTANCE OF RAIL RATES FOR HAULING COAL TO ELECTRIC CUSTOMERS IN NEW ENGLAND;
- SECOND, THE NEED TO RETAIN COMPETITION AND THE POTENTIAL FOR COMPETITION AMONG EASTERN RAILROADS;
- THIRD, OUR EXPERIENCE WITH RAIL CONTRACTS, COMPETITION, AND THE RATES CHARGED BY NORFOLK SOUTHERN;
- FOURTH, OUR CONCERN ABOUT LOSS OF COMPETITION AND BELIEF THAT THE SALE OF CONRAIL TO NORFOLK SOUTHERN WOULD LEAD TO 20% TO 25% INCREASES IN RATES WE PAY CONRAIL TO MOVE COAL;
- FIFTH, THE FACT THAT SITUATIONS SUCH AS OURS WERE NOT CONSIDERED BY THE JUSTICE AND TRANSPORTATION DEPARTMENTS; AND
- FINALLY, WE BELIEVE THERE IS A BETTER ALTERNATIVE.

WITH THAT BRIEF INTRODUCTION, I'D LIKE TO TURN TO THE DETAILS:

A. RAIL RATES FOR HAULING COAL HAVE AN IMPORTANT IMPACT ON ELECTRIC BILLS

TO UNDERSTAND OUR CONCERN, IT IS FIRST IMPORTANT TO RECOGNIZE THAT COAL AND THE COST OF HAULING COAL NOW HAVE AN SIGNIFICANT IMPACT ON ELECTRIC BILLS IN NEW ENGLAND.

1. INCREASED USE OF COAL IN LIEU OF FOREIGN OIL

OUR FOREMOST OBJECTIVE IS TO PROVIDE RELIABLE ELECTRIC SERVICE AT THE LOWEST PRACTICABLE COST. THE COST OF FUEL TO GENERATE ELECTRICITY IS IMPORTANT BECAUSE IT MAKES UP ABOUT 35% OF OUR TOTAL COSTS OF PROVIDING ELECTRIC SERVICE.

We have taken major steps to hold down fuel costs and, simultaneously, to reduce dependence on foreign oil. In 1979, NEES was 78% dependent on foreign oil. Today, coal supplies 50% of the energy we need to generate electricity and oil only 25%.

This change resulted from conversion of 6 generating units from oil to coal -- at a cost of nearly $300 million. The conversion has been an environmental and economic success. It will continue to be a good deal for our customers as long as the delivered cost of coal is reasonable and we do not have to switch back to oil.

This year, we will burn about 3.5 million tons of coal and avoid burning about 15 million barrels of oil.

2. Coal sources and transportation routes
Within the U.S., we can obtain coal meeting our needs in Pennsylvania, West Virginia, and Virginia. We move this coal to East Coast ports by railroad (there is no practical alternative). Specifically, coal from Pennsylvania is moved over Conrail to Philadelphia; coal from West Virginia moves via Chessie (B&O and C&O) to Baltimore and Newport News. Coal from Virginia and several counties in southwestern West Virginia moves via Norfolk Southern's N&W railroad to Norfolk.

From these East Coast ports, we then move coal via ship and barge to our generating plants in New England. There are no rail lines to our plants.

Several other utilities in New England are converting plants from oil to coal and their coal moves over similar routes.

3. Rail costs are an important part of total delivered coal cost
On average, the cost of our coal at the mine accounts for 65% of the total delivered cost; rail transport is 25%; and ocean transport is 10%.

The cost of fuel and transportation is, of course, paid by electric customers. In fact, each year our customers pay more than $40 million for rail transport of coal -- or more than $3 per month per customer.

B. Rail Rates for Hauling Coal are Excessive and, at Present, Competition Among Railroads -- if and when available -- is the Only Protection for Coal Producers and Users
The second point I wish to make is that rail rates for hauling coal are excessive; there is no effective regulatory protection at present; and competition among railroads is the only current hope for coal producers, utility coal users and their electric customers.

1. Rail rates for hauling coal grew rapidly from 1973 to 1982 and are excessive

From 1973 to 1982, rates increased by 191% -- an annual rate of 12.6% -- according to the BLS Coal Rate Index data published

BY THE ASSOCIATION OF AMERICAN RAILROADS (AAR). RATES FOR COAL GREW FASTER THAN FOR OTHER COMMODITIES.

2. THERE IS NO EFFECTIVE REGULATORY PROTECTION AVAILABLE FOR COAL SHIPPERS UNDER THE STAGGERS RAIL ACT AND THE ICC

   ICC REGULATION OF RAILROADS PRIOR TO THE STAGGERS RAIL ACT OF 1980 WAS BURDENSOME TO THE RAILROADS, CONTRIBUTED TO RAILROAD INEFFICIENCIES, AND PROVIDED LITTLE PROTECTION TO SHIPPERS.

   THE STAGGERS ACT WAS WIDELY TOUTED AS THE SOLUTION TO EVERYONE'S PROBLEMS -- BUT IT DID NOT TURN OUT THAT WAY. IT HAS WORKED WELL FOR RAILROADS BUT NOT FOR COAL PRODUCERS, UTILITY COAL USERS AND THEIR CUSTOMERS. THE ICC'S LONG STRING OF DECISIONS FAVORING RAILROADS HAS MAGNIFIED THE DEFICIENCIES IN THE ACT AND INCREASED THE BURDEN AND COSTS FOR SHIPPERS.

   UNTIL THE CONGRESS CHANGES THE STAGGERS ACT, THE ONLY PROTECTION AGAINST MONOPOLY PRICING BY RAILROADS IS IN THOSE SITUATIONS WHERE THERE IS COMPETITION -- THAT IS, COMPETITION AMONG RAILROADS OR WITH OTHER FORMS OF TRANSPORTATION. WHEN MOVING COAL EASTWARD FROM APPALACHIAN AREAS, THERE ARE NO ALTERNATIVES TO RAIL TRANSPORT.

   IF NORFOLK SOUTHERN WERE PERMITTED TO ACQUIRE CONRAIL, THE NEED FOR REGULATORY PROTECTION WOULD BE EVEN GREATER BECAUSE OF SHARPLY REDUCED COMPETITION -- OR AT LEAST THE POTENTIAL FOR COMPETITION -- AMONG EASTERN RAILROADS.

C. COMPETITION AMONG EASTERN RAILROADS HAS BEGUN TO HELP TEMPER EXCESSIVE RAIL RATES FOR SHIPPERS WHO HAVE ALTERNATIVES

   THE THIRD POINT THAT I WANT TO MAKE IS THAT COMPETITION AMONG EASTERN RAILROADS -- NORFOLK SOUTHERN, CHESSIE, AND CONRAIL -- HAS BEGUN TO WORK TO TEMPER EXCESSIVE RAIL RATES, AT LEAST FOR SHIPPERS THAT HAVE CLEAR ALTERNATIVES.

   1. WE HAVE BEGUN TO SEE COMPETITION AND HAVE GAINED SOME EXPERIENCE UNDER RAIL CONTRACTS

      AS INDICATED EARLIER, WE CAN OBTAIN COAL MEETING OUR NEEDS FROM PENNSYLVANIA, WEST VIRGINIA, AND VIRGINIA AND WE CAN MOVE THAT COAL TO EAST COAST PORTS OVER 3 DIFFERENT RAIL SYSTEMS. IN THEORY, OUR SITUATION SHOULD HAVE PROVIDED A PERFECT OPPORTUNITY TO SEE COMPETITION BRING ABOUT LOWER RATES FOR MOVING OUR COAL AS SOON AS THE STAGGERS ACT PASSED. THE STAGGERS ACT PROVIDED CLEAR AUTHORITY FOR RAILROADS TO ENTER INTO CONTRACTS WITH SHIPPERS AND AMPLE FLEXIBILITY TO ADJUST RATES DOWNWARD AS WELL AS UPWARD.

      OUR COMPANY LEARNED THAT CONTRACTS AND RATE RELIEF DO NOT COME EASILY. DESPITE OUR STRONG EFFORTS, IT WAS NOT UNTIL MARCH, 1983 -- NEARLY 2½ YEARS AFTER THE STAGGERS ACT -- THAT WE WERE ABLE TO GET OUR FIRST CONTRACT AND SOME RATE RELIEF. THAT CONTRACT WAS WITH NORFOLK SOUTHERN'S NORFOLK & WESTERN RAILROAD.

IT WAS NOT UNTIL AUGUST, 1984 THAT WE WERE ABLE TO NEGOTIATE A CONTRACT WITH CONRAIL -- NEARLY 4 YEARS AFTER STAGGERS. LAST MONTH WE SIGNED A CONTRACT WITH CHESSIE SYSTEM RAILROADS -- NEARLY 4½ YEARS AFTER THE STAGGERS ACT.

2. COMPETITION AMONG EASTERN RAILROADS HAS HELPED US GET BETTER RATES, BUT WE HAVE NOT YET OBTAINED RATES THAT ARE REASONABLE WHEN MEASURED AGAINST RAILROADS' COSTS

   WE BELIEVE THAT WE WILL HAVE ACHIEVED "REASONABLE" RATES WHEN THOSE RATES DO NOT EXCEED THAT RAILROAD'S FULLY ALLOCATED COST OF PROVIDING OUR RAIL SERVICES, INCLUDING A FAIR RETURN ON EQUITY. PERHAPS NEEDLESS TO SAY, WE BELIEVE THAT COSTS SHOULD BE CALCULATED USING GENERALLY ACCEPTED ACCOUNTING PRINCIPLES -- NOT THOSE APPROVED BY THE ICC FOR THE RAILROADS.

3. OUR HIGHEST RATES ARE THOSE ON NORFOLK SOUTHERN'S N&W RAILROAD

   I CANNOT REVEAL SPECIFIC TERMS OF OUR VARIOUS CONTRACTS. BUT, I CAN ASSURE YOU THAT THE RATES WE PAY ON THE N&W ARE HIGHEST WHETHER MEASURED IN TERMS OF DOLLARS PER TON, THE RATIO OF REVENUE (I.E., RATES) TO VARIABLE COSTS, OR REVENUE TO FULLY-ALLOCATED COSTS.

   OUR CONCLUSIONS ABOUT RATES WE NOW PAY ARE BASED ON DETAILED COST DATA COMPILED BY CONSULTANTS WHO ARE EXPERTS IN RAIL RATE MATTERS. THESE EXPERTS HAVE FOLLOWED THE TRAINS CARRYING OUR COAL; IDENTITIED EQUIPMENT AND MANPOWER USED; RECORDED THE TIME REQUIRED; AND CALCUALTED THE COSTS INCURRED BY RAILROADS TO CARRY OUR COAL. CALCULATIONS ARE DERIVED FROM COST DATA REPORTED TO THE ICC.

   THESE ANALYSES MAKE CLEAR THAT THE RATES BEING CHARGED BY NORFOLK SOUTHERN'S N&W ARE WELL ABOVE FULLY-ALLOCATED COSTS, INCLUDING A FAIR RETURN ON EQUITY. IN FACT, WE BELIEVE NORFOLK SOUTHERN'S RETURN ON EQUITY FOR OUR COAL MOVEMENTS IS IN EXCESS OF 37% BEFORE TAXES AND 26% AFTER TAXES.

   THE RATES CHARGED BY NORFOLK SOUTHERN ARE WELL ABOVE THOSE WE PAY UNDER OUR CONTRACTS WITH OTHER RAILROADS.

D. WE ARE CONCERNED ABOUT THE LOSS OF COMPETITION AND THE CLEAR POTENTIAL THAT WE WOULD BE SUBJECTED TO HIGHER RATES IF NORFOLK SOUTHERN WERE PERMITTED TO ACQUIRE CONRAIL

THUS, THE FOURTH POINT I WANT TO MAKE IS THAT WE ARE CLEARLY CONCERNED ABOUT THE LOSS OF COMPETITION PROVIDED BY CONRAIL AND THE CLEAR POTENTIAL THAT WE WILL BE SUBJECTED TO HIGHER RATES IF NORFOLK SOUTHERN WERE PERMITTED TO ACQUIRE CONRAIL AND RAISE CONRAIL'S RATES.

1. IN OUR CASE, THE POTENTIAL FOR COMPETITION AMONG 3 RAIL SYSTEMS WOULD IMMEDIATELY BE REDUCED TO ONLY 2 SYSTEMS

2. **Using Norfolk Southern's rate policies, rates for our coal on Conrail could increase by 20% to 25% or $2.25 to $2.75 per ton**

   Our concern about rates and our calculations are based on the analyses referred to earlier. The 20% to 25% and $2.25 to $2.75 numbers merely show the results if Norfolk Southern were to acquire Conrail and apply the same revenue to cost policies on Conrail movements that are now used on the N&W.

3. **The basic unfairness to our customers is clear**

   Our customers have every reason to complain. For the past 4 years, they have been paying high rates charged by Norfolk Southern -- which rates have returned handsome profits to Norfolk Southern. Undoubtedly, those profits have contributed to the reserve of capital that Norfolk Southern now proposes to use to purchase Conrail. Then, if the sale is approved, our customers probably can look forward to paying higher rates for coal moved on the Conrail system.

   In short, our customers are paying and paying and paying again for excessive rail rates.

   We ask that you not allow this to continue. The potential for competition should be retained.

4. **Continuing Conrail policies**

   We understand that Norfolk Southern has committed to continuing certain Conrail policies and practices if it is permitted to buy Conrail. However, we have yet to see any commitments that existing contracts would be honored or that rates will not be raised.

E. **Our Situation Apparently was not Considered in the Analysis of Competition Conducted by the Justice Department**

The fifth point I wish to make is that our situation apparently was not considered in the analysis of competition conducted by the Justice Department.

Thus far, we have seen only limited information on the study conducted by the Justice Department that led to the conclusion of the Assistant Attorney General for Anti-trust that certain limited actions by Norfolk Southern would remove his anti-trust concerns about the proposed acquisition of Conrail. I am referring to his January 29, 1985 letter to Secretary Dole (including its attachments).

As nearly as we can tell, the study dealt only with freight movements between certain origins and final destinations. We could find no indication that the Anti-trust Division's study considered the loss of competition in cases of coal shipped from mines in Appalachia to East Coast ports for export or for coastwise shipment to other U.S. destinations. This appears to be a major weakness in the analysis.

We urge that you insist upon a more thorough study of the true anti-competitive aspects of the proposed acquisition.

F. There Must be a Better Way of Disposing of the Government's Interests in Conrail

The final point I wish to make is that there must be a better way of disposing of the Federal Government's interests in Conrail.

We fully support the Reagan Administration's objective of ending the Federal Government's ownership in Conrail and regret having to oppose the alternative selected after such a long effort by the Administration. But, we take comfort in the fact that there appear to be alternatives that would achieve the same objective without the loss of competition or the threat of higher rates on Conrail.

I should also point out that we believe the service we are provided by Norfolk Southern is excellent. The N&W has moved over 5 million tons of coal for us during the past 4 years. However, as indicated earlier, we believe their rates are excessive and we are well aware that producers served by the N&W are finding it increasingly difficult or impossible to compete for our business with coal producers served by other railroads with whom we have achieved contracts.

We have also found that Conrail provides excellent service and we believe Conrail's rates are more reasonable.

We believe that keeping Conrail independent of other railroads is a worthy objective. After 4 years since passage of the Staggers Act, we are beginning to see benefits of competition among the railroads. That potential should be kept alive -- rather than limited by further concentration of railraod ownership.

Further concentration of market power certainly will increase the need, and the demands, for regulatory protection for shippers and their customers.

In conclusion, we urge you to prevent the acquisition of Conrail by Norfolk Southern and to consider other alternatives, including the sale to a non-rail entity or a public stock offering,that would make Conrail truly independent.

Thank you.

The CHAIRMAN. Mr. Massey.

STATEMENT OF E. MORGAN MASSEY

Mr. MASSEY. Thank you, Mr. Chairman, and members of the committee, for inviting me to appear on your panel today.

My name is Morgan Massey. I am president of A.T. Massey Coal Co., Inc., headquartered in Richmond, VA.

In 1984, our company sold and shipped 23.6 million tons of bituminous coal. This makes us the second-largest coal producer and shipper in the Appalachian region served by Conrail and by the Norfolk Southern rail systems.

Our operations include mines on both the Conrail and CSX in Pennsylvania and mines on both the CSX and the Norfolk Southern in West Virginia and Kentucky. In Tennessee, our mines have the advantage of river and truck transportation to serve industrial plants from Atanta to Nashville. It is ironic to note that the CSX rail line, that previously served these mines, has rusted out from lack of use. Since 1980, the railroad does not have to compete because it can charge its overhead and profit to the captive shipper.

As you well know, Senator Thurmond, we built and operate a coal terminal in Charleston, SC. This was to take advantage of what we thought would be a competitive rail situation between the CSX and the Norfolk Southern who both serve Charleston. As it turns out, this oligopoly has produced identical freight rates between the two railroads to Charleston carefully equalized with the freight rates to the port of Hampton Roads and to the port of Baltimore.

It is only the Conrail that has been willing to aggressively compete for export rail traffic on the basis of a more favorable price to those coal mines captive to their railroad.

When the Chessie System merged with the Family Line to form the CSX prior to the Staggers Rail Act, I appeared before the ICC on behalf of the coal industry to testify in favor. At that time, our problem was service. Price was controlled by the ICC. Railroads like the L&N were having trouble getting rate adjustments approved fast enough in that inflationary period. When the Norfolk Southern and the Southern railroads teamed up, I again appeared before the ICC in favor of this merger. We had just passed the Staggers Rail Act. The coal industry still naively expected that the ICC would continue to provide a reasonable rate for captive shippers of coal.

I well remember that I commented at the time that I could not support the merger if the ICC accepted the proposal of the railroads to exclude export freight rates altogether from jurisdiction. I predicted that this would destroy the competitive position of the U.S. coal in the world market.

And you know what happened—the ICC indeed totally deregulated export rail rates on coal. Export coal rates skyrocketed from $9 to $16 per ton. A.T. Massey Coal Co.'s export tonnage dropped from 9.1 million tons in 1980 to 3.6 million tons last year, even though our company had invested $160 million to provide coal terminals at Newport News and Charleston.

When you listen to the railroads talk about competition in the rail industry, you have to listen closely. There are two kinds of competition in our free enterprise system. One is service, and the other is price. In a free market, they move together. That is, quality of service improves, and price is reduced in periods of declining demand. That is the supply and demand system. Railroads since Staggers too often talk about competition in terms of service alone. For captive shippers such as coal, railroads are allowed to price transportation at whatever level will cover fixed costs and profits allocated solely to captive tonnage.

There are many advantages to the coal shipper in an end-to-end combination of Conrail and Norfolk Southern. Indeed, it offers a number of single-service opportunities to a wider customer base than coal mines operating on either railroad have enjoyed in the past. This would certainly be an improvement in service. But, for the coal mines in northern West Virginia and Pennsylvania that enjoyed even a modest competitive situation on price, this merger produces a closed network of even more totally captive shippers.

Although reduced to a more modest profit level, the legislation still allows the railroads to disproportionately charge their captive tonnage higher prices to provide fixed charges and profits of the railroad. In other words, when the price goes up, volume comes down. This means that the railroad must charge even higher unit prices to captive shippers to become what the law calls revenue adequate.

Therefore, before I can support a position either for or against the Norfolk Southern/Conrail merger, I feel that Congress must fix what is broken, that being the monopolistic pricing allowed the railroads under the Staggers Rail Act.

You know that the coal industry and the coal burning electric utilities have teamed up in a coalition known as CURF to reform the Staggers Rail Act and put stricter definition to rail revenues that can be extracted from the shipper who has no alternative transportation choice. Although reduced to a more modest profit level, the CURE legislation still allows the railroads to disproportionately charge their captive tonnage higher prices to provide the fixed charges and profits of the railroad. When the price goes up, the volume goes down. This means that the railroad must charge even higher unit prices to captive shippers to become "revenue adquate".

That is what I say is broken in our free enterprise system. That is what is wrong with the Staggers Act. That continues to be what is wrong with the CURE reform legislative package.

To me, the simplest solution to this dilemma has been proposed by Senators Simpson and DeConcini of your committee in the proposed Railroad Anti-Monopoly Act of 1985, Senate bill 447. Obviously, the railroads cannot be, and ought not be, both deregulated and exempt from a certain level of antitrust responsibility.

You gentlemen well remember that the immunity of railroads from the antitrust laws was established back in 1920 in a very important case involving the Chicago and Northwestern Railroad Co. At that time, the ICC had been allowed authority to prescribe the maximum as well as the minimum rates to be applied to rail traffic. The Supreme Court held that since Government price regulation under the ICC exists, railroads were no longer subject to the Sherman and Clayton Acts.

Today, the railroads argue that since the ICC continues to exist and has some residual authority over them, parties injured by anticompetitive railroad pricing have no rights under antitrust laws.

The Simpson-DeConcini legislation will promptly establish reasonable rates for captive shippers at competitive levels. In a nutshell, if a monopoly railroad attempts to extract monopoly profits, it would have to open its tracks to competitors, or else face treble damage action under the same antitrust laws by which all the rest of us in business must abide.

My message to you gentlemen is, that until Congress "fixes what is broken" and returns railroads to the mainstream of the free enterprise system, there is no rational decision that can be made on the Government's disposition of Conrail.

The CHAIRMAN. Thank you very much.

Mr. Edwards.

STATEMENT OF ROBERT A. EDWARDS

Mr. EDWARDS. Chairman Thurmond, my name is Robert A. Edwards. I am vice president of transportation for the Early & Daniel Co., Inc., Cincinnati, OH. The Early & Daniel Co., Inc. is a subsidiary of Early & Daniel Industries, located in Indianapolis, IN.

The Early & Daniel Co. is a regional grain company with six grain terminals in Ohio, Indiana, and Kentucky. Our affiliated companies are Tidewater Grain, Inc., whose export terminal is located in Philadelphia, PA, and Acme-Evans, a wheat processor located in Indianapolis, IN. The companies merchandise and warehouse grain and grain products, providing a variety of both domestic and export services to the grain industry in the Eastern United States. Within the last calendar year, 60 percent of the affiliated companies' total rail tonnage moved by Conrail.

Since the inception of the Staggers Rail Act of 1980, we have seen a resurgence of the rail industry. Within the last 5 years, we have also noted an acceleration of mergers within the transportation industry. Rail carriers have extended their economic reach in other transportation modes such as pipelines, trucking, and in one instance, a barge line.

One of the primary safeguards for the shipping public in the Staggers Rail Act of 1980 was congressional intent to promote competition. We fail to understand how competition is enhanced with fewer and fewer alternatives. We believe there has to be an equitable balance between the carriers and the public's interest. Competition fostered by deregulation has improved both productivity and service.

We are very concerned regarding the long-term impact of the Department of Transportation's proposed sale of Conrail to the Norfolk Southern Corp. It appears that the sale of track to Guilford Industries is a quick-fix solution to some serious antitrust considerations.

In the present environment, many of the smaller regional rail carriers are hard pressed to compete for markets with the larger class I carriers. We have no desire to reappear before this committee in the future to express our views on what must be done to resurrect rail competition, or provide Federal subsidies for the small regional rail carriers.

Conrail has been both innovative and aggressive in the marketing of its rail services. In our economic sector, Conrail has expanded its existing markets and provided additional marketing opportunities to its customers. Conrail's resurgence from its bankrupt predecessors to profitability has proven its ability to compete in a competitive market environment.

We believe the best option in the interest of the Government, the taxpayers, shippers, and Conrail's employees is a public stock offering. Although there are other benefits to a public stock offering, we will limit our comments to our perspective as a shipper utilizing Conrail's service.

We believe a public stock offering would be beneficial to the shipping community in the following areas: An independent Conrail preserves competition in the public interest; an independent Conrail can devote more resources toward strategic planning of service and equipment; and the present management and employees will remain intact and have a vested interest in providing the best service to the shipping public.

It is our hope that Congress will give serious consideration to a public stock offering and carefully review the proposed sale of the Consolidated Rail Corp.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Mr. Berg, we would be glad to hear from you.

STATEMENT OF GEORGE L. BERG, JR.

Mr. BERG. Thank you, Mr. Chairman.

My name is George Berg, and I am here representing the American Farm Bureau Federation. Farm Bureau is the Nation's largest general farm organization, with a membership exceeding 3 million member families in 48 States and Puerto Rico.

I appreciate the opportunity to appear before the Senate Judiciary Committee to outline Farm Bureau's position endorsing the sale of Conrail to the Norfolk Southern Corp.

At the annual meeting of the American Farm Bureau Federation earlier this year, our voting delegates recommended that Conrail be returned to the private sector. Based upon a Department of Transportation study of the competitive bids and the recommendations that the Federal Government share its share of Consolidated Rail Corp. to Norfolk Southern, we believe the proposal should be promptly and favorably approved by the Congress. Norfolk Southern's purpose in buying Conrail is to gain access to Northeast and East-West markets. Shippers of both Norfolk Southern and Conrail can look forward to expanded markets, more single-line rates, and fewer cancellations of joint rates and routes.

Norfolk Southern has had an excellent record of moving farm products, especially grain, from the Midwest to the Southeastern United States. If this merger is approved, Norfolk Southern will be in a position to provide more direct routes, faster shipments, and better use of equipment. We believe the merger will create new opportunities that will be helpful to agriculture and increase the efficiency and competitiveness of rail service in the Northeast and the Midwest.

Farm Bureau believes there would be a number of advantages offered to shippers by Norfolk Southern. The railroad has a sound transportation background, making Conrail financially sound and assuring shippers of continued rail service. The acquisition would represent a market extension for Conrail and Norfolk Southern. It would provide a high degree of operating efficiencies and permit more competitive rates and services to be offered rail shippers and receivers. The merger would also result in two balanced and competitive rail systems east of the Mississippi River.

Not only does the sale of Conrail to Norfolk Southern assure competition between two financially strong railroad systems in the East, but it also gives shippers the opportunity to enjoy greater competition from smaller railroads. In its effort to become less dependent upon Federal subsidy, Conrail closed numerous gateways by canceling joint rates on a massive scale. The effect of some joint rate cancellations has been to preclude some carriers from serving markets in the Northeast and Midwest. Before the Staggers Rail Act of 1980, joint rates provided shippers equal rates and the only competitive benefit was service.

After the Staggers Act, joint rates provided both service and price competition through the use of allowance contracts—that is, a shipper could get a volume discount from some carriers, thereby lowering the cost of a joint rate by using a specific route.

Norfolk Southern, as part of its original offer to buy Conrail, agreed to reestablish certain joint rates so that smaller carriers could reenter the Northeast market on a competitive basis. Standing alone, Conrail is not in a financially secure enough position to tolerate such competition. Howver, if permitted to merge, Norfolk Southern will be financially secure, and the combined system and recapture traffic that has left the rail system because of Conrail's present need to surcharge interchanged traffic.

Mr. Chairman, the Federal Government should not be in the business of running railroads. Now that Conrail is financially healthy and attractive to a number of bidders, it should be returned to the private sector.

The Secretary of Transportation, with the advice and assistance of all interested parties, has recommended Norfolk Southern on the basis that it would leave Conrail in the strongest financial position after the sale, best preserve service to Conrail shippers, and give the taxpayers the best rate of return possible. Norfolk Southern's bid was reviewed and approved by the Treasury Department for tax implications and by the Justice Department for competitive aspects. If we wish to get the Federal Government out of the railroad business, we believe the logical approach would be to sell Conrail to the Norfolk Southern Corp.

In our opinion, Norfolk Southern's selection by the Department of Transportation as the successful bidder for the Conrail system offers a sensible, financially sound solution to the Government's desire to return Conrail to the private sector. Norfolk Southern's long-term commitment to railroad service, its experience in managing a consolidated interterritorial rail system, and its substantial financial resources make it the best choice to purchase Conrail's extensive rail system.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much.

We have given all of you now a chance to present your side of it. I see the distinguished Senator from Arizona has come in. There is one gentleman here, I think, who endorses the merger and favors your bill, S. 447, Senator.

Senator DECONCINI. It just so happens I would like to ask him some questions.

The CHAIRMAN. Go ahead.

Senator DECONCINI. Thank you, Mr. Chairman.

Mr. Massey, I have had a chance to review your statement, even though I was not here, and I see that you like Senate bill 447, which I think is very outstanding on your part to come to such an intellectual conclusion of that nature.

You make references to captive shippers. Can you just explain a little bit for the record what that really is?

Mr. MASSEY. Well, a captive shipper is a shipper of usually a bulk commodity who has, because of his location, no alternative transportation route other than the railroad; there is not an alternative mode such as a barge facility. And usually, his commodity is of such specific gravity, it precludes any quantities of it being hauled over the highways because of the highway weight laws.

Senator DECONCINI. So it would really only be by railroad or by sea or waterway.

Mr. MASSEY. That is right.

Senator DECONCINI. And, having no other alternative. Are the coal companies generally captive shippers?

Mr. MASSEY. Typically, of the coal companies in the United States, about 85 percent of them are captive—well, 85 percent of the coal in the United States is shipped by rail, and I believe about 80 or more percent of that coal that is shipped by rail is captive.

Senator DECONCINI. Eighty-five percent of the coal is shipped by rail, and 80 percent of that would be considered captive.

What other types of shippers have the greatest trouble and the problem with captive shipping?

Mr. MASSEY. Well, other commodities such as ore, grain, fertilizer, dry chemicals, forest products. I might mention that oil and gasoline, of course, are typically of a bulk commodity that is not captive shipper, because it does have the right of eminent domain for pipelines, and so you see very little of that big bulk commodity hauled by the railroad.

Senator DECONCINI. And, as a coal shipper, do you have any alternative other than rail transportation, that you use?

Mr. MASSEY. For short hauls, trucks are possible and are competitive in the shorter haul, quicker turnaround distance.

Senator DECONCINI. What is considered a short haul?

Mr. MASSEY. Oh, up to 100 miles.

Senator DECONCINI. Beyond that, as a coal shipper, how much of yours is short haul and how much is long haul?

Mr. MASSEY. Well, in the Appalachian region, virtually all of it is longer than 100 miles.

Senator DECONCINI. And you have no other alternative.

Mr. MASSEY. Some 5 percent of the business moves short haul by truck.

Senator DECONCINI. In your capacity, have you objected or participated in any way with previous mergers of railroads?

Mr. MASSEY. As I said in my testimony, I have supported both the Norfolk Western and the Southern merger, and also, the Chessie System, when they merged the C&O, the B&O and the Family Lines all together.

Senator DECONCINI. So you certainly are not one who opposes in principle, or just because you have been a captive shipper, the idea of merging for efficiency purposes?

Mr. MASSEY. We think that everything the railroads have said about mergers is good for railroads—no question about it. It gives them more flexibility to ship end-to-end, straight-through hauls. There is a tremendous advantage to these mergers.

Senator DECONCINI. Have those mergers that you have supported helped your industry at all?

Mr. MASSEY. They have been of value to the industry in giving captive shippers the availability of shipping to locations that were precluded in joint rate situations before, when there was regulation under the ICC.

Senator DECONCINI. Here is the suspense question. How would you fix the captive shippers problem?

Mr. MASSEY. Well, I think the fastest and quickest solution to that is the bill that you, sir, introduced, S. 447, sponsored by yourself, Senator Simpson, Senator Andrews, and Senator Nickles.

Senator DECONCINI. In your opinion, how would that bill affect the railroads?

Mr. MASSEY. Well, it immediately and almost overnight establishes reasonable rates for captive shippers at a competitive level.

Senator DECONCINI. That does not mean a loss, right?

Mr. MASSEY. No, that does not mean a loss. It does it in a very simple way. In a nutshell, if the railroad who has the monopoly attempts to extract the monopoly profits, he would have to open his tracks to competitors or else face treble damages under the same antitrust laws that all of us have to live by.

Senator DECONCINI. So in your judgment, it would permit them to make a profit; it would permit them to be the sole transporter of that coal if they wanted to, as long as their quoted price was not one that someone in competition could use that same rail for; is that correct?

Mr. MASSEY. That is correct.

Senator DECONCINI. Do you believe, Mr. Massey, that it is good policy to apply the antitrust laws to the railroad industry in general?

Mr. MASSEY. I think where you have the captive shipper situation, that the exemption granted to railroads in the 1920 case that exempted railroads generally from antitrust regulation, should be reapplied. That is the one area where railroads do not have the benefit of a competitive situation of the free marketplace of setting the ultimate rate.

Senator DECONCINI. If Congress were to approve the sale of Conrail in one form or another, do you believe it could be advantageous to attempt to also tie to the sale legislation similar to S. 447, or something like that?

Mr. MASSEY. Well, I am not experienced in the political—I do not want to say——

Senator DECONCINI. Well, that is all right. In your judgment, would S. 447 enhance the competition in that particular area of the Conrail service versus the other railroads that are there?

Mr. MASSEY. I think that if you had a competitive situation for the captive shippers such as your bill provides that you have the advantages of a merger, and you have the advantages of the competitive free enterprise system both working in your favor. So, you would have the advantages of both worlds.

Senator DECONCINI. So if you have a merger—and there are those who are worried about that merger, that it may become less competitive—and then if you still have the ability of legislation something like 447 for captive shippers, then you could probably have it both ways; you could have your cake and eat it too. You could approve the merger, but also provide for competition.

Mr. MASSEY. Absolutely.

Senator DECONCINI. Thank you very much, Mr. Massey.

Thank you, Mr. Chairman. That is a fine witness.

The CHAIRMAN. He evidently agrees with you. [Laughter.]

Are there any other questions for the other witnesses?

[No response.]

The CHAIRMAN. Gentlemen, I want to thank all of you for your appearance here today. We appreciate your coming. Thank you very much.

Our next panel includes: David Webb, manager of transportation information, A.E. Staley & Co., Decatur, IL; Jerome Butler, production planning director and traffic superintendent, Interstate Paper Co., Riceboro, GA; William B. Rose, director, distribution and traffic, Witco Chemicals, Inc., New York, NY; Jack E. Hunger, president, World Shipping, Inc., Cleveland, OH; Ronald H. Brown, with Patton, Boggs & Blow, for the Committee of Railroad Shippers, Washington, DC.

Gentlemen, without objection, your entire statements will be placed in the record, and you now have 5 minutes each.

We will start with you, Mr. Webb, so you may proceed.

STATEMENT OF A SHIPPERS PANEL INCLUDING J. DAVID WEBB, MANAGER OF TRANSPORTATION INFORMATION, A.E. STALEY & CO., DECATUR, IL; JEROME BUTLER, PRODUCTION PLANNING DIRECTOR AND TRAFFIC SUPERINTENDENT, INTERSTATE PAPER CO., RICEBORO, GA; WILLIAM B. ROSE, DIRECTOR, DISTRIBUTION AND TRAFFIC, WITCO CHEMICALS, INC., NEW YORK, NY; JACK E. HUNGER, PRESIDENT, WORLD SHIPPING, INC., CLEVELAND, OH; AND RONALD H. BROWN, PATTON, BOGGS & BLOW, ON BEHALF OF COMMITTEE OF RAILROAD SHIPPERS, WASHINGTON, DC

Mr. WEBB. Thank you.

My name is J. David Webb, and I am manager of information of the corporate transportation division for the A.E. Staley Manufacturing Co. We are a wholly owned subsidiary of Staley Continental, with annual sales in excess of $2 billion. We are an international agribusiness company with corn processing plants in Illinois, Indiana, Pennsylvania, and Tennessee. We process in excess of 125 million bushels of corn annually. Until recently, we also had soybean processing plants in Illinois, Indiana, Missouri, and Ohio. In fiscal 1984, we shipped in excess of 10,000 cars by Conrail. Obviously, we have a significant interest in what happens to this railroad and the area it serves.

In analyzing the various possibilities for the future of Conrail, we are concerned about the quality of service we will receive, the costs we will incur in shipping into or out of the area involved, and the impact the change will have on our customers and our operations. These things are of great concern to our company and must be taken into account as we consider the future of Conrail.

However, one issue is of paramount importance. We feel that regardless of any other concerns, we must be assured of good railroad service in this area. We cannot afford to have a situation like that which existed when the area was served primarily by the Penn Central, or even in the early days of Conrail. While other factors may be important in our deliberations, this service assurance is an absolute must. And of all the alternatives which have been presented, the Norfolk Southern acquisition appears to be the only alternative which will assure this service.

The Norfolk Southern is already a major railroad in the United States. They are strong financially and over the years, have demonstrated their ability to run a railroad. Their recent merger and the strong system that resulted from that merger is evidence of their ability to integrate railroad systems. Various financial experts appear to disagree about the financial aspects of the other alternatives. However, we hear no disagreement concerning either the financial viability or the ability to manage a railroad system of this magnitude about the Norfolk Southern.

We cannot afford to gamble on this issue. We must choose the alternative which meets this requirement. Thus, our choice is for the Norfolk Southern.

Having made this determination, the issue should be clear. However, other potential problems do need to be considered. Most of those have been mentioned this morning. The most important of these is the issue of competition. Should the Norfolk Southern acquire Conrail, all of our corn processing plants will be located on the Norfolk Southern. Two of these plants are in locations where there will be no other railroad service. Obviously, we would like competition. But we do not feel that intramodal competition is mandatory for us to achieve the desired results. What is needed is a relationship between shipper and carrier which allows the shipper to meet his needs and also provides a return profitable for the carrier.

We have had a long association with Norfolk Southern. Over the years, we have found their marketing/sales organization recognizes the distribution needs of their shippers and have reacted to meet those needs. In almost every case, we have been able to meet the dual objectives of shipper needs and carrier profit, even in those situations where intramodal competition did not exist. Therefore, we do not feel, at least as it relates to our company, that the lack of intramodal competition would be a serious problem for us in this situation.

We have had an excellent relationship also with the people in Conrail. We sincerely hope that it will be possible for them to remain in the positions they now hold so that relationship could continue. However, if we have to sacrifice something, we feel it is better to have an economically viable railroad in place than it is to have a continuing relationship with good people who must struggle against insurmountable odds.

In conclusion, we feel the acquisition of Conrail by Norfolk Southern is the only solution which meets the long-term needs of our company, its employees, and our customers, and of the public generally. We wholeheartedly recommend this acquisition and hope you will concur.

Thank you.

The CHAIRMAN. Mr. Butler.

STATEMENT OF JEROME BUTLER

Mr. BUTLER. Thank you, Mr. Chairman.

My name is Jerome Butler. I am production planning and traffic superintendent for Interstate Paper Corp., located in Riceboro, GA.

Interstate Paper is a manufacturer of pulpboard, which we ship throughout the eastern third of our country. In 1984, 60,000 tons, or 30 percent of our production, was shipped to or across the lines of Consolidated Rail Corp. Locally, we are served only by the Seaboard System Railroad. As a captive rail shipper, we are extremely sensitive to any change that might further reduce our competitive position.

The proposed sale of Consolidated Rail Corp. to Norfolk Southern Corp. will allow the Norfolk Southern to dominate the major traffic flows into and across the Northeast. Because of this monopolistic situation, they will be in a position to set prices at whatever level is necessary to make a profit. Without adequate competition, there will be no incentive to control costs.

If left a separate railroad, Conrail will have the incentive to control costs. This is due in part to the current level of competition between Conrail and Norfolk Southern. Shippers cannot afford to lose this competitive situation.

Conrail's chairman has attacked the DOT proposal as one that destroys competition in the area. He calculates the current head-to-head competition between Norfolk Southern and Conrail to be worth $500 million a year in rail revenue. He also argues that no real competition will be generated by providing trackage rights to the Guilford and P&LE railroads, because these two roads are too weak to compete with the combined Norfolk Southern/Conrail system. Who could know more about this situation than Mr. Crane?

We support keeping Conrail a separate railroad through a public offering of stock. A public offering should return more cash to the Government and be more consistent with current deregulatory efforts designed to create a more competitive environment.

For the smaller company, of which we are one, flexibility in approach to the marketplace and awareness of the role of competition are everyday necessities of life. It is our firm belief that the sale of Conrail to Norfolk Southern will create an inflexible giant incapable of relating to those realities of true competition upon which companies such as ours depend for survival.

Thank you.

The CHAIRMAN. Thank you.

Mr. William B. Rose, we would be pleased to hear from you now.

STATEMENT OF WILLIAM B. ROSE

Mr. ROSE. Thank you, Mr. Chairman.

My name is William B. Rose. I am director, distribution and traffic, of Witco Chemical Corp., located in New York City.

I am a graduate of New York University with a bachelor of science degree in Commerce.

I have been involved in transportation for 38 years, with Witco 23 years and in my present capacity 22 years. I am authorized to make the statement on behalf of Witco.

Witco has sales of approximately $1.5 billion and 62 plants throughout the United States. In New Jersey, Pennsylvania, and Ohio, we have eight plants online with Conrail, terminating and originating traffic. There are 1,600 employees involved at these locations.

As such, we have a vital concern in rail service in the Northeast. We are concerned that the recommendations of the Department of Transportation for the sale of Conrail will result in a less competitive climate with more restrictions on alternatives for shippers.

Industry has been assured of open routes and reciprocal shipping at Conrail points. But the divestiture plan provides no mechanism to assure this. Another important concern is with shipments originating in the North and terminating in the South, as well as movements within the South. Nothing has been addressed in this area. Open gateways and reciprocal switching have to be encouraged to prevent the Seaboard from becoming a switchline and putting them in an unprofitable and uncompetitive situation.

Witco has always supported the concept of an efficient, competitive rail system. Over the past several years, we have seen so many rail mergers that now, there are only a handful of systems remaining. Efficiency has improved, but competition has become diminutive. This merger will further exacerbate the problem.

The combined financial strength of the merged Conrail/Norfolk Southern will be so overwhelming that neither the P&LE or Guilford combined could compete with them. Ninety-three percent of the equipment in the territory will be owned by the merged Conrail/Norfolk Southern. They are being offered rail corridors, many of which are in deplorable condition and in some areas, only have 90- to 105-pound rail. We question whether they have the financial resources to bring it up to standard.

NERSA expressed a congressional preference that Conrail be transferred as a single entity. We as shippers are being offered a sop to competition of conveying unwanted track from the Norfolk Southern to Guilford and the P&LE. There has been concern that the Alleghany Corp. would dispose of Conrail after a 5-year commitment. The same 5-year commitment holds true for the Norfolk Southern.

Concern has also been voiced about Alleghany Corp. operating Conrail because of its investment in the old Penn Central without recognizing that the Alleghany Corp. operated the C&O from 1929 to 1954 and was one of the few railroads operated profitably during the Depression.

The other alternative we favor is the Morgan Stanley proposal for a public marketing of a stock issue. Surely, there are risks involved, but they would be a better alternative to what the DOT is proposing. Everyone—shippers, receivers, and political personalities agree that Stanley Crane and his team have done a masterful job in putting Conrail on the right track. Why reinvent the wheel?

The two corporations have a different business philosophy. The internal conflicts after mergers would be enormous. Conrail is the largest piggyback carrier in the country, primarily East-West. The Norfolk Southern is more of a bulk commodity carrier North-South. The Union Pacific, the old Missouri Pacific, is the largest originator of tank car traffic, and Conrail is the largest terminator of tank car traffic in the country via the St. Louis & St. Elmo gateways. Is this traffic going to be disrupted because of rate cancellations or route restrictions?

Another great concern to Witco is, if this sale goes through, that the B&O will become financially insolvent. That, according to the CSX annual report, may be disposed of. This would put our company in an untenable situation, as we also have four plants on the B&O.

By manipulating rates in both the Northeastern and Southern sections of the country, the Norfolk Southern will be able to influence where new plants or new production facilities will be located. This could increase the demise of jobs in the Northeast and the relocation of facilities from the Northeast to the South.

In conclusion, it is our feeling that the sale of Conrail to Norfolk Southern would create more problems than it will solve.

The intransigent attitude of the Department of Transportation reminds me of Pontius Pilate—wash our hands of the problem, and let the shippers suffer forever.

Thank you.

The CHAIRMAN. Thank you.

Mr. Jack E. Hunger.

STATEMENT OF JACK E. HUNGER

Mr. HUNGER. Thank you, Senator Thurmond.

My name is Jack E. Hunger. I am president of World Shipping, Inc., Cleveland, OH. This is my first official visit to Washington, and I thank the committee for the invitation to be here and present my comments and opinions regarding the Conrail sale to the Norfolk Southern.

My company has served the international trade industry in the Midwest over the past 25 years as shipping agents and have especially been involved in the intermodal movement of cargo utilizing marine containers.

These activities rely heavily on an efficient and cost-effective rail network linking the Midwestern States with the major coastal ports. We are, therefore, vitally concerned that the eventual acquisition of Conrail is successfully achieved by a knowledgeable and committed entity to maintain a service level benefitting the commerce of our region.

The consensus of opinion within our organization is in support of the Norfolk Southern Corp.'s acquisition of Conrail. This opinion is supported through our past experience which has found the Norfolk Southern to be responsive to the market demands of shippers and receivers in both service and pricing. We believe their proven experience and innovative commitment to user needs makes them the most logical choice to acquire the Conrail network.

It is especially significant to our industry that the acquirer of Conrail have a thorough understanding of our industry's needs. This knowledge and concern has been demonstrated by Norfolk Southern by their willingness to provide both trailer on flatcar and container on flatcar services. They are the only railroad serving this region to offer both of these required forms of service. Continued expansion of intermodal facilities and the efficiencies, we believe, would be the result of the Norfolk Southern's takeover. Our day-to-day experience in working with the Norfolk Southern has always been quite positive, and we would welcome their presence and style of operation in this important corridor now covered by Conrail.

While our company utilizes both motor carrier and rail piggyback services, we believe there is an essential need to assure the latter's long-term viability, especially with regards to overall fuel conservation and capital formation.

The Norfolk Southern's proposal makes sense to us as it will ensure a profitable, long-term, experienced rail operating entity to serve the Midwestern and Atlantic corridors with competitive and dependable service.

I, therefore, urge the Senate committee and your colleagues in Congress to approve at the earliest date the recommendation of your Department of Transportation to permit the Norfolk Southern to acquire Conrail.

Thank you.

The CHAIRMAN. Thank you, Mr. Hunger.

Mr. Ronald H. Brown.

STATEMENT OF RONALD H. BROWN

Mr. BROWN. Thank you very much, Mr. Chairman and Senator Specter.

My name is Ronald H. Brown, and I am a partner in the Washington law firm of Patton, Boggs & Blow. It is a pleasure for me to present this testimony on behalf of the Committee of Railroad Shippers [CORS]. CORS is a coalition of large bulk and merchandise shippers which depend heavily upon Conrail's service. Its members are Allied Corp., Detroit Edison, Dupont, General Motors, and United Parcel Service.

CORS organized early in 1984 to address the need to maintain the competitive transportation environment, service levels, and standards that Conrail has been developing in the Northeast and Midwest over several years. Today, CORS is neither endorsing nor opposing the sale of Conrail to the Norfolk Southern Corp., but rather, is urging the Congress to incorporate in the transfer legislation a number of provisions we believe are essential to the maintainence of rail competition in the Conrail region.

Since the Department of Transportation first began to explore the sale of Conrail, the CORS group has expressed interest and some concern about the ultimate content of legislation to effect the sale. Of foremost importance to CORS is the adoption of certain shipper protections in either or both the Conrail transfer legislation and the definitive agreement between the ultimate purchaser and DOT. Specifically, we recommend changes in these important documents to address the following common interests of shippers: First, maintenance of a competitive transportation environment; second, viability of Conrail and other competing carriers in the Northeast and Midwest regions; third, protection against abrogation of Conrail-shipper contracts and other agreements; fourth, preservation of existing service levels and standards established by Conrail; fifth, continued access to gateways; and sixth, shipper rights to enforce certain shipper-related covenants in the memorandum of intent and definitive agreements.

While CORS supports a transfer of Conrail to the private sector, it cannot endorse S. 638 without provision for these shipper protections.

In the view of the U.S. Government's substantial ownership interest at stake, CORS believes that it is appropriate to include certain provisions in the transfer legislation that would not necessarily be applicable to other railroads in other transactions. Specifically, the following five provisions, we believe, should be included in the legislation before you today.

CORS recommends an amendment to the purposes clause of the transfer legislation, stating that among its purposes is to assure the preservation and enhancement of rail competition in the Northeast and Midwest, consistent with the needs of such service areas.

Second, CORS believes that the primary substantive deficiency of the transfer legislation is the absence of any provision prohibiting contract abrogation. Further, in view of the substantial Government investment in Conrail, CORS believes that the Congress should have the right to review all key documents related to Conrail's sale and the subsequent performance of the railroad.

To ensure appropriate congressional understanding and review of the crucial decisions related to the Conrail transfer, the definitive agreements should be reviewed by the Congress before they are executed and take effect.

Other key documents that should be subject to some form of congressional review are the compliance certificates which the memorandum of intent requires to be submitted to DOT periodically by Conrail's purchaser.

In addition, last summer, CORS reviewed DOT's draft transfer legislation, the Conrail Sales Amendments of 1984, and the July 1984 draft of the memorandum of intent. On September 26, 1984, CORS expressed its views on these documents in a letter to John Riley, Administrator of the Federal Railroad Administration. A copy of that letter is attached to our full testimony for the committee's information.

Among the views expressed in that letter was the need for a legal mechanism in the transfer legislation to enable shippers to sue to enjoin violation of the covenants in the definitive agreement that affect shippers.

CORS recommends deletion of section 16(c) of the memorandum of intent so that shipper assertion of such rights and claims is permissible. In addition, we recommend amendment of the transfer legislation to provide shippers the affirmative right to seek injunctive relief against violation of any specific covenants in the memorandum of intent or provisions of the pertinent definitive agreement that affect shipper interests.

To remedy another potential deficiency in the memorandum of intent, CORS urges rigorous congressional scrutiny of section 16(c) of the revised memorandum of intent which permits the Secretary of Transportation to waive covenants in the memorandum.

The CHAIRMAN. Your time is up. We will place the remainder of your statement in the record.

Mr. BROWN. Thank you very much, Mr. Chairman.

[The following was received for the record:]

TESTIMONY
on
THE CONRAIL SALE AMENDMENTS OF 1985
before the
SENATE COMMITTEE ON THE JUDICIARY
on behalf of
THE COMMITTEE OF RAILROAD SHIPPERS
APRIL 2, 1985

Mr. Chairman and Members of the Committee. My name is Ronald H. Brown and I am a partner at Patton, Boggs & Blow in Washington, D.C. It is an honor and pleasure for me to return to the Committee today to present testimony on S. 638, the Conrail Sale Amendments of 1985 on behalf of the Committee of Railroad Shippers (CORS). CORS is a coalition of large bulk and merchandise shippers which depend heavily upon Conrail service. Its members are Allied Corporation, Detroit Edison Company, E.I. Dupont de Nemours & Co., General Motors Corporation, and United Parcel Service. CORS organized early in 1984 to address the need to maintain the competitive transportation environment, service levels and standards that Conrail has been developing in the Northeast and Midwest over the last several years. Today, CORS is neither endorsing nor opposing the sale of Conrail to the Norfolk Southern Corporation, but rather is urging the Congress to incorporate in the transfer legislation a number of provisions we believe are essential to the maintenance of rail competition in the Conrail region.

I. General Policy Position

Since the Department of Transportation (DOT) first began to explore the sale of Conrail, the CORS group has expressed interest and some concern about the ultimate content of legislation to effect the sale. Of foremost importance to CORS is adoption of certain shipper protections in either or both the Conrail transfer legislation and the "Definitive Agreement" (contract for sale) between the ultimate purchaser and DOT. Specifically, we recommend changes in these important documents to address the following common interests of shippers: (1) maintenance of a competitive transportation environment; (2) viability of Conrail and other competing carriers in the Northeast and Midwest regions; (3) protection against abrogation of Conrail-shipper contracts and other agreements; (4) preservation of existing service levels and standards established by Conrail; (5) continued access to gateways; and (6) shipper rights to enforce certain shipper-related covenants in the Memorandum of Intent and Definitive Agreements. While CORS supports a transfer of Conrail to the private sector, it cannot endorse S. 638 without provision for these shipper protections.

II. Specific Legislative Recommendations

The Conrail transfer legislation has been submitted to the Congress for review pursuant to the 1981 Northeast Rail Services Act Amendments (NERSA) to the Regional Rail Reorganization Act providing for the sale of the United States Government's common stock holdings in Conrail.

In view of the U.S. Government's substantial ownership interest at stake, CORS believes that it is appropriate to include certain provisions in the transfer legislation that would not necessarily be applicable to other railroads in other transactions. Specifically, the five provisions, discussed below, should be included in S. 638.

A. Purposes Clause on Competition

The purpose of any Conrail transfer legislation is to carry out the provisions of NERSA regarding the sale of the U.S. Government's common stock holdings in Conrail. Accordingly, it is appropriate that the transfer legislation reflect some of the more important directives of NERSA. CORS recommends an amendment to the "Purposes" clause of the transfer legislation stating that among its purposes is to assure the preservation and enhancement of rail competition in the Northeast and Midwest consistent with the needs of such service areas.

B. Prohibition Against Contract Abrogation

CORS believes that the primary substantive deficiency of the transfer legislation is the absence of any provision prohibiting contract abrogation. Many of our members have long-term contracts with Conrail, the terms of which must survive any transfer. The testimony of several witnesses, including those for DOT and Norfolk Southern, have stated that Conrail contracts would be assumed if Conrail were sold to an independent entity. However, the revised Memorandum of Intent contains no provision addressing the assumption of existing Conrail contracts approved pursuant to the Staggers Act. Therefore, CORS is preparing an amendment to the transfer legislation to ensure the such contracts are honored, and we would like to submit the amendment for your Committee's review.

C. Congressional Approval of the Definitive Agreement

In view of the substantial Government investment in Conrail, CORS believes that the Congress should have the right to review all key documents related to Conrail's sale and the subsequent performance of the railroad. The first of such documents are the Definitive Agreements between the purchaser of Conrail and DOT which will implement the Memorandum of Intent. As currently drafted, the transfer legislation contemplates Congressional review of only the Memorandum of Intent, not any of the Definitive Agreements. It is presumed that all of the covenants and other particulars of the draft Memorandum of Intent will be incorporated into the Definitive Agreement constituting the final contract of sale. However, the Memorandum states that it is not binding on the parties and indicates only that such Definitive Agreement will follow the Memorandum only to the extent possible. To ensure appropriate Congressional understanding and review of all the crucial decisions related to the Conrail transfer, the Definitive Agreements should be reviewed by the Congress before they are executed and take effect.

Other key documents that should be subject to some form of Congressional review are the "Compliance Certificates" which the Memorandum of Intent requires to be submitted to DOT periodically by Conrail's purchaser. CORS recommends that these certificates be submitted to the principal jurisdictional committees -- the Senate Committee on Commerce, Science and Transportation and the House Committee on Energy and Commerce -- for review. Furthermore, CORS recommends that notice of submission of each Certificate be published in the Federal Register and a copy of the Certificate made available to the public. Thus, both the Congress and interested shippers and other groups would have an opportunity to monitor the railroad's operation. In particular, shippers would have adequate notice of the railroad's activities that might give rise to assertion of certain rights or claims, as discussed in the next section.

D. Enforceability of Certain Shipper-Related Covenants

Last summer, CORS reviewed DOT's draft transfer legislation, the Conrail Sale Amendments of 1984, and the July, 1984 draft of the Memorandum of Intent. On September 26, 1984, CORS expressed its views on these documents in a letter to John Riley, Administrator of the Federal Railroad Administration. A copy of that letter is attached for the Committee's information. Among the views expressed in that letter was the need for a legal mechanism in the transfer legislation to enable shippers to sue to enjoin violation of the covenants in the Definitive Agreement (contract of sale) that affect shippers. Although the drafts of the transfer legislation and Memorandum of Intent authorized DOT to seek injunctive relief against a covenant violation, CORS' letter recommended that DOT amend its proposed legislation to give private parties legal means for redress.

Contrary to CORS' request, however, DOT did not include in either the transfer legislation or the revised Memorandum of Intent any provision permitting a shipper to enforce any shipper-related covenants in the Memorandum of Intent or the Definitive Agreement constituting the contract of sale. In fact, the revised Memorandum of Intent, section 16(c), explicitly excluded the assertion of rights and claims by third parties.

CORS recommends deletion of section 16(c) of the Memorandum of Intent, so that shipper-assertion of such rights and claims is permissible. In addition, we recommend amendment of the transfer legislation to provide shippers the affirmative right to seek injunctive relief against violation of any specific covenants in the Memorandum of Intent or provisions of the pertinent Definitive Agreement that affect shipper interests.

To remedy another potential deficiency in the Memorandum of Intent, CORS urges rigorous Congressional scrutiny of section 16(c) of the revised Memorandum of Intent which permits the Secretary of Transportation to waive covenants in the Memorandum. Since very little attention has been focused on this waiver provision thus far, at a minimum DOT should be required to explain in detail during the legislative process the circumstances in which it envisages use of such waivers. Beyond that, CORS recommends one of two alternatives. The first would be a legislative amendment to require an opportunity for public comment on Conrail's purchaser's request for a waiver before such waiver is granted by the Secretary. In the alternative, CORS recommends that legislation bar waivers of covenants altogether.

E. Maintenance of Service Levels and Standards

As early as September, 1984, when CORS advised the Federal Railroad Administration of its concerns about the draft transfer legislation and Memorandum of Intent, we raised specific questions regarding the meaning and intent of the covenant on maintenance of service in section 12(a)(ii) of the draft Memorandum. That section required the purchaser of Conrail "to maintain the maximum level of rail service throughout its system that is economically sustainable . . ." At that time, CORS recommended that the content of this obligation in section 12(a)(ii) be stated in greater detail.

Unfortunately, the revised Memorandum of Intent has narrowed, rather than expanded, the maintenance of service obligation as well as the definition of such obligation. Specifically, the revised Memorandum states in section 12(a)(ii)(1) that Conrail's purchaser must "maintain rail freight services throughout its system that are economically justifiable . . ." CORS, therefore, urges the Congress to incorporate in the transfer legislation the language originally contained in section 12(a)(ii) of the July, 1984 draft Memorandum of Intent.

III. CORS Concerns about Continued Rail Competition in Conrail Territory

Of most immediate concern to this Committee, and certainly to the members of CORS, is the assurance that any disposition of Conrail will not reduce or eliminate healthy rail-to-rail competition in the Northeast and Midwest. CORS' position on the competitive issue is well established. In its first letter to DOT dated July 17, 1984, the CORS group made the following statements:

> [W]e believe the most important competitive issue is whether [DOT's] selection will result in the elimination of gateways, the termination of reciprocal switching agreements, and the cancellation of competitive joint rates. Therefore, we urge the sale be made with legally binding provisions assuring access to major markets by more than one carrier through trackage rights, reciprocal switching agreements, joint ownership of appropriate belt and terminal systems, or other means.

The recent Department of Justice study of the potential anticompetitive impact of Conrail's sale to the Norfolk Southern Corporation was an essential first step in the scrutinizing review process necessitated by Conrail's sale to any single major railroad. Many CORS members completed questionnaires issued by the Department.

At this point, CORS believes it would be helpful to a full evaluation of the competitive issues under discussion if the valuable information developed by the Justice Department were disclosed to the Congress and the public. This would permit independent analysis of some of the competitive issues that were examined by the Department and others that were not addressed as fully. These issues include identification of the rail lines that would be affected by the divestiture remedy proposed by the Department, consideration of other remedies (e.g., gateway access, reciprocal switching, joint trackage rights, etc.), and the impact of the proposed Conrail-Norfolk Southern merger on shipments of two of Conrail's important commodities -- coal and chemicals. Since several CORS members have substantial coal and chemical shipments in the Conrail region, some bidders for Conrail presented studies to CORS on the potential impact that their acquisition of Conrail would have on these important commodity shipments. We believe Congress should have the benefit of a fuller analysis of the future environment for coal, chemical and other important commodity shipments in the region, whether in a Justice Department supplement to its report or in an independent study of the proposed transfer.

It is CORS' understanding that a number of additional steps have been taken recently to develop this type of information. For example, Chairman John Dingell of the House Committee on Energy and Commerce has written a lengthly letter to the Department of Justice asking a series detailed questions about the competitive effects of the transfer. The responses, if timely provided, should significantly amplify the information already made available by the Department. In addition, we understand that Chairman Dingell has requested the United States Railway Association to undertake an independent study of the competitive aspects of the proposed Conrail sale. In CORS' opinion, these steps will help develop the information needed for the proper assessment of the competitive environment in the Midwest and Northeast after Conrail's transfer.

It must be remembered that the Congress established NERSA's Conrail transfer procedures as a substitute for an Interstate Commerce Commission (ICC) merger proceeding. In such a proceeding, the ICC must consider, for example:

> (i) the effect on the adequacy of transportation to the public;
>
> (ii) the effect of including, or failing include, other rail carriers in the area involved in the proposed transaction; . . .

> (v) the effect on competition among rail carriers in the affected region. 11 C.F.R. § 1180.1(b)(1) (1984).

In addition, the ICC requires submission of a substantial amount of supporting information (see 11 C.F.R. § 1180.6), market impact analyses (see 11 C.F.R. § 1180.7), and extensive operational and financial information (see 11 C.F.R. §§ 1180.7, 1180.8).

According to Justice Department statements, its study conformed to the requirements of an ICC merger analysis. Part of such an ICC proceeding, however, is the public availability of much of the information submitted. To the extent possible, Congress should ensure that its record on this issue includes the important details of Conrail's transfer before it acts on S.638, rather than accept the legislation as is, with the details to be worked out afterwards.

In sum, more information must be collected and reviewed regarding the rail lines proposed for divestiture, and the nature of any pending agreements relating to the future disposition of such lines. As part of this competitive analysis, consideration should be given to the possibility of encouraging and permitting negotiations for the sale of certain Conrail lines to rail carriers not now involved in such negotiations. We also think equal consideration should be given to certain measures to ensure continued competition, including, where necessary, access to the gateways, retention and possible expansion of reciprocal switching agreements and joint rates, exploration of additional joint trackage rights, and joint ownership of appropriate belt and terminal systems.

IV. Conclusion

To summarize the CORS' position, we believe that the shipper protections we have outlined in this testimony must be included in the pending Conrail transfer legislation for it to have our support. Specifically, CORS urges adoption of amendments to: (1) establish as a purpose of the transfer legislation the preservation and enhancement of rail competition in the Conrail region; (2) prohibit contract abrogation; (3)

require Congressional approval of the Definitive Agreement; (4) provide for Congressional and public review of Compliance Certificates; (5) grant shippers the right to enforce shipper-related covenants; and (6) make provision, where necessary, for gateway access, reciprocal switching agreements, joint trackage rights, or other measures to maintain rail-to-rail competition.

Mr. Chairman, I and the members of the Committee of Railroad Shippers very much appreciate this opportunity to present our views to you today. I would be happy to answer any questions the Committee may have.

Attachment

PATTON, BOGGS & BLOW
2550 M STREET, N. W.
WASHINGTON, D. C. 20037

September 26, 1984

Mr. John Riley
Federal Railroad Administrator
U.S. Department of Transportation
400 7th Street, S.W.
Washington, D.C. 20590

Dear Mr. Riley:

Thank you for your letter responding to the Committee of Railroad Shippers (CORS) position regarding the sale of the federal government's interests in Conrail. CORS has reviewed the "Conrail Sale Amendments of 1984" and the draft of "Memorandum of Intent", and wants to advise you of its views on those documents.

CORS endorses the Department's intention to create legally binding provisions designed to protect the financial viability of Conrail. As CORS' letter explained, CORS would like the Department to include covenants to protect Conrail's cash balance, define the appropriate conditions for dividend distributions, establish a minimum level of annual capital expenditures, and restrict the subsequent sale or merger of Conrail.

While CORS is pleased the Department of Transportation is pursuing these provisions, it is troubled by the approval process envisioned in the Conrail Sale Amendments. The proposed legislation seems to provide for Congressional approval of both the "potential purchaser" and the Memorandum of Intent. Yet the final, and presumably only, binding obligations on the purchaser will be found in the "Definitive Agreement" (the contract of sale) -- which DOT does not intend to be subject to Congressional review.

There are several other questions and concerns that CORS would like to raise. First, CORS questions the intent of the covenant in paragraph 12(a)(ii) of the Memorandum of Intent that requires the purchaser of Conrail "to maintain the maximum level of rail service throughout its system that is economically sustainable." We read the scope of the provision as being greater than merely to protect against abandonments, and the content of that obligation should be stated in greater detail.

Second, the draft "Memorandum of Intent" provides that the contract for the purchase of Conrail will contain a requirement that the buyer file over the next five years certificates of compliance. These certificates appear to be aimed at assuring that the buyer obeys the affirmative and negative covenants contained within the contract of sale. CORS believes these certificates of compliance should be made public and should be submitted regularly to the appropriate committees of Congress.

Third, there should be a legal mechanism in the legislation enabling shippers to sue to enjoin violation of the covenants in the contract of sale that affect them. The "Conrail Sale Amendments of 1984" authorize DOT to seek injunctive relief against a covenant violation. We urge the Department to amend its proposed legislation to give private parties legal means for redress.

Fourth, many CORS members are parties to contracts with Conrail. The Conrail Sale Amendments of 1984 and the Definitive Agreement should legally bind the purchaser to honoring existing Conrail contracts with the shippers. While all bidders for Conrail seem to agree with this point, CORS believes it should be made an explicit and legally binding provision of the sale.

Finally, while CORS has not addressed in this letter the competitive effects of the sale of Conrail, that issue continues to be a most serious concern, and we intend to make it the subject of a subsequent letter to you.

We look forward to discussing the proposed legislation and the draft Memorandum of Intent with you.

Sincerely,

John Oberdorfer

John L. Oberdorfer

cc: Mr. Chris Rooney

JLO:mlg

The Chairman. Now, I have one question here that I want to ask any of you who care to answer it. To the extent that you have not already said, could you describe the ways in which your company might benefit from a rail merger, such as from single-line service, long-haul rates, or shorter delivery time, or ways in which the merger might reduce your shipping options?

We will start with you, Mr. Webb, if you care to answer that.

Mr. Webb. I think what you alluded to, the first three things that you mentioned, the single-line service, et cetera, you would eliminate a lot of problems with interchange of carriers—those kinds of things, we look at as improvements in service. I think our main concern goes back to having a viable railroad. That is really the basis of our whole option.

It will probably also detract from some of our operations. We may not get as good a deal with the new railroad as we had with the old. That is incumbent upon our negotiating prowess.

So there are pros and cons with everything.

The Chairman. The three things I mentioned were single-line service, better long-haul rates, or shorter delivery service.

Mr. Rose.

Mr. Rose. Senator, referring to what Mr. Massey said earlier, of the 62 plants—I will not say all 62 are on railroads—but of all the plants that we have on railroads in our corporation, I only have one that is on two railroads, which happen to be involved in a merger—the Santa Fe and the Southern Pacific.

I can assure you that I have the best of both worlds out in California right now. Every other plant, we originate either on a B&O or a Conrail or whatever, and our only ability to reduce our costs are on interline traffic into, perhaps, the South, into the Midwest, or whatever, by having a choice of alternate railroads at a specific gateway.

And what I alluded to in my statement was that we have many shipments into the South out of New Jersey, and I can visualize that I would be forced to ship to Atlanta, for example, to a Seaboard destination, and be forced to ship Conrail, Norfolk Southern, and the Seaboard end up with just a switch. The Seaboard is not going to like this, so they are going to raise the switching charges, and we get into all kinds of hassles.

Long haul does have certain advantages, but when you have the option to pick and choose your carrier, you are getting the best of freight rates that you can negotiate. And without that ability, we become more captive than less captive.

The Chairman. Anyone else?

Mr. Hunger.

Mr. Hunger. Yes; I definitely feel that the intermodal services would be much improved by the merger, not only by efficiencies, but by the aggressive operations and operating philosophy that the Norfolk Southern has proved in the past. For example, from Ohio, it is not possible to move a container on flatcar to New York or Baltimore on Conrail. They only take boxes that are set up on chassis and wheels. Well, the NS has had a history of putting that type of service in, and that would be a definite efficiency.

The Chairman. Does anyone else have a comment? [No response.]

The **Chairman**. We thank all of you for coming, and we appreciate your appearance.

We will now ask the fourth panel to come forward: Mr. Patrick Falvey, assistant executive director of the Port Authority of New York and New Jersey; Mr. John J. Malone, president, Philadelphia Port Corp.; Mr. Larry Baldner, South Carolina State Ports Authority, for Don Welch, executive director.

Now, some other ports that are for and against will file statements. I believe the Port of Norfolk will file a statement in favor of the merger, so I am informed.

[The following was received for the record:]

March 21, 1985

The Honorable Strom Thurmond
Chairman, Committee on Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am opposed to the proposed acquisition of Conrail by Norfolk Southern. This consolidation could be very detrimental to our company's business. The current Southern rate tariffs, as used by NF, have created an almost impossible advantage to customers using the NF in the South. We have been fighting for years a difference of more than 60% in rail rates to Southern customers. We have lost considerable market share, not due to the price of our product but simply due to the lower freight costs in the NF system.

If the NF acquires Conrail, I suspect the unfair rate advantage would be imposed on Northern traffic via Conrail, and once again we would have to fight an unreasonable freight advantage to those suppliers using the NF/Conrail system.

Thus, I feel this merger would create an unfair advantage and hope the Government's recommendation will be changed and allow an independent (non-rail) company to acquire Conrail. I suggest that the employees be allowed to purchase it.

Very truly yours,

HAR-TRU CORPORATION

R. M. Funkhouser, Jr.
President

RMFJR/b

South Carolina Farm Bureau Marketing Assoc.
GRAIN DIVISION
TELEPHONE (803) 747-0441 POST OFFICE BOX 5/88 WATS 1-800-322-1791
North Charleston, South Carolina 29406

March 27, 1985

The Honorable Strom Thurmond
Committee on The Judicial
U. S. Senate
22 Dirksen Office Building
Washington, D. C. 20510

Dear Senator Thurmond:

I appreciate this opportunity to submit my views in writing, as a previous committment prevents me from testifying in person.

I am the General Manager of the South Carolina Farm Bureau Marketing Association, which is the export grain facility in North Charleston, South Carolina. We have managed this facility for twenty-three years and export between 15 and 20 million bushels of soybeans, wheat, and corn annually.

We are very interested in the disposition of Conrail because of the additional marketing opportunities or lack thereof, depending on your decision. I feel that it is fortunate that a financially healthy railroad such as Norfolk Southern is available to continue the uninterrupted service of the Conrail system. Norfolk Southern can provide the competitive factor that is needed in the Northeast and, more importantly, link these areas to the Southeast.

Many times we must bring in unit trains to meet our quality committments on soybeans. These shipments originate in the Northeast and Midwest and must be routed on the lines of several railroads. This makes freight complicated and expensive.

Norfolk Southern's proposed acquisition of Conrail would open many markets to the Southeast, lower transportation cost, and provide quicker transit time.

We are in complete support of Norfolk Southern's acquisition of Conrail.

Sincerely,

James M DeVeaux

James M. DeVeaux
General Manager

OPERATING CHARLESTON PORTS AUTHORITY TERMINAL ELEVATOR

Lukens Steel Company
Coatesville, PA 19320

Robert F. Toia
Manager
Traffic and Transportation

March 20, 1985

Honorable Strom Thurmond
Chairman - Committee on Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

As a member of an industry heavily dependent on rail transportation and a company celebrating its 175th anniversary of steel making, we wish to submit our statement in support of Conrail's public offering proposal.

MY NAME IS ROBERT F. TOIA, MANAGER OF TRAFFIC AND TRANSPORTATION FOR LUKENS STEEL SINCE 1976. LUKENS IS THE NATION'S THIRD LARGEST STEEL PLATE PRODUCER WITH MANUFACTURING PLANTS LOCATED IN COATESVILLE AND CONSHOHOCKEN, PENNSYLVANIA. BOTH PLANTS ARE SERVICED BY CONRAIL AND DEPENDENT ON CONRAIL FOR TRANSPORTATION OF RAW MATERIALS AND FINISHED PRODUCTS.

WITH CONRAIL'S OPERATION CONCENTRATED IN THE NORTHEAST THERE SHOULD BE NO QUESTION AS TO THE INCENTIVE TO CONTINUE THE CAPITAL INVESTMENT PROGRAM, COMBINED WITH TIME PROVEN MANAGEMENT, THAT HAS PRODUCED A MODERN, STRUCTURALLY SOUND AND PROFITABLE TRANSPORTATION COMPANY, SECOND TO NONE, WHERE OTHERS HAVE FAILED. CERTAINLY THE EMPLOYEES OF CONRAIL RECOGNIZE THE IMPACT ON THEIR FUTURES SHOULD CONRAIL BE ACQUIRED BY ANOTHER RAILROAD AND HAVE PROVEN THEIR DEDICATION TO MAINTAINING A STRONG VIABLE RAILROAD.

THE PRESENCE OF THREE MAJOR RAILROADS IN THE NORTHEAST-MIDWEST PROVIDES A COMPETITIVE BENEFIT TO ALL INDUSTRY. CONRAIL'S AGGRESSIVE MARKETING TECHNIQUES AND WILLINGNESS TO INNOVATE, WORK WITH BOTH INDUSTRY AND RAIL CONNECTIONS, LARGE AND SMALL, HAS CREATED AN INTERMODAL COMPETITIVE ENVIRONMENT RESULTING IN AN EFFICIENT TRANSPORTATION SERVICE AT A REASONABLE COST. RETURNING CONRAIL TO THE PRIVATE SECTOR AS ONE OF THREE MAJOR NORTHEAST-MIDWEST CARRIERS WILL CONTINUE THE HEALTHY COMPETITIVE EVNIRONMENT ENJOYED BY INDUSTRY SINCE DEREGULATION OF THE RAILROAD INDUSTRY.

THE NORFOLK SOUTHERN SUBSIDIARY, THE NORFOLK AND WESTERN, PERMITTED PHYSICAL AND FINANCIAL DETERIORATION OF THEIR NORTHEASTERN RAILROAD

PROPERTIES AND EVENTUALLY DIVESTED ALL OWNERSHIP. UNLESS THE NORFOLK SOUTHERN DEDICATES THE CAPITAL AND MANAGEMENT REQUIRED TO THRIVE IN THE NORTHEAST WE WILL HAVE A RETURN TO THE DETERIORATION AND BANKRUPTCIES THAT EXISTED IN 1976. THIS IS A MAJOR CONCERN OF INDUSTRY NATIONWIDE.

AS AN ILLUSTRATION OF ELIMINATION OF COMPETITION COATESVILLE, PA IS ACCESSED BY BOTH CONRAIL AND CSX. SHOULD NORFOLK SOUTHERN ACQUIRE CONRAIL AND CSX FOLLOW THROUGH WITH A REDUCTION OF SERVICE IN THE NORTHEAST, WE WILL LOSE CSX SERVICE. ELIMINATION OF CSX WILL RENDER COATESVILLE SHIPPERS CAPTIVE TO THE NORFOLK SOUTHERN, REDUCE OUR NEGOTIATING POSTURE AND REQUIRE CIRCUITOUS ROUTES LENGTHENING TRANSIT TIMES TO CUSTOMERS LOCATED TO THE SOUTH AND SOUTHEAST.

DESPITE CONRAIL'S SUCCESSFUL REHABILITATION OF SIX PREVIOUSLY BANKRUPT COMPANIES DURING DIFFICULT RECESSION YEARS, CONCERN IS EXPRESSED AS TO THE CONTINUATION OF PROFITABILITY IN A DIFFICULT NORTHEASTERN MARKET. 1985 MAY WELL PROVIDE THE ANSWER. CONRAIL HAS MOVED CLOSER TO OPERATING AS A PRIVATE SECTOR. IN ADDITION TO A 1985 ONE-HALF BILLION DOLLAR CAPITAL PROJECT COVERING TRACK REHABILITATION, EQUIPMENT AND COMMUNICATIONS, WAGES AND BARGAINING HAVE BEEN RESTORED TO NATIONAL LEVELS. CONRAIL'S ABILITY TO CONTINUE COMPETITIVE SERVICE AND PROFITABILITY IN A DECLINING MARKET AND DIFFICULT OPERATING AREA, WHILE ASSUMING MAJOR COST INCREASES SHOULD PROVIDE THE ANSWER TO CONTINUATION OF FUTURE OPERATIONS AND PROFITABILITY.

WE HAVE EVERY CONFIDENCE THAT CONRAIL'S PROVEN RECORD JUSTIFIES OUR SUPPORT AND BELIEF IN THEIR ABILITY TO OPERATE AS A COMPETITIVE PRIVATE SECTOR COMPANY. FOR THIS REASON WE URGE YOUR FAVORABLE CONSIDERATION TO THE PUBLIC OFFERING PROPOSAL.

Respectfully submitted,

Robert F. Toia

Robert F. Toia, Manager
Traffic & Transportation

Ports of Philadelphia MARITIME EXCHANGE

913 LAFAYETTE BUILDING, PHILADELPHIA, PA. 19106 (215) 925-1522

HENRY F. CORRY PRESIDENT
SAMUEL M. SCHELLENGER VICE-PRESIDENT
WILLIAM A. HARRISON EXECUTIVE DIRECTOR & SECRETARY
CHARLES E. MATHER III TREASURER
JAMES F. YOUNG, ESQ SOLICITOR

April 1, 1985

Senator Strom Thurmond, Chairman
Committee on Judiciary
United States Senate
Room 218 Russell Senate Office Bldg.
Washington, D.C. 20510

Dear Senator Thurmond:

I am writing to express the views of the Ports of Philadelphia Maritime Exchange relevant to the proposed sale of Conrail. The Ports of Philadelphia Maritime Exchange representing more than 200 members who comprise private business concerns at the Ports of Philadelphia, Camden, Gloucester and Wilmington are vitally concerned with several issues surrounding the proposed sale.

Our first concern is relevant to an anti competitive situation which exists currently at our ports involving access for competitive rail service. Today, unfortunately, we are the captive of a single rail carrier. In the legislation establishing Conrail we thought that this anti competitive situation would be remedied. We now feel however that this remedy must be precisely set out during the present deliberations on Conrail. It has been proposed to both Norfolk Southern and Conrail Management that this port requires restoration of competitive access.

The Maritime Exchange is also concerned that a continuing flow of adequate capital funding exists and is carried on by the owners of the Conrail System. We do not feel that the creation of a railroad terminal company to operate Conrail would be useful to our port.

We have conducted interviews with management representatives of Conrail, Norfolk Southern, Guildford and CSX. During those interviews Norfolk Southern indicated that they would be willing to review port development plans in the Ports of Philadelphia and participate when it was in their best interest. We were also told that additional marketing opportunities may be made available for the Ports of Philadelphia through new ownership. We have been diligently studying and evaluating these statments and responses of the management representatives relevant to the proposed sale. The purpose of the Maritime Exchange in this undertaking has been to determine in an intelligent and thoughtful manner which of these options would present the best opportunities for the Ports of Philadelphia. To date we have not formulated a position. We believe however that the open access question is pivotal in our decision making process. We expect to inform you and other members of the Judiciary Committee as well as other cognizant committees of Congress as soon as we have reached a final decision.

We are disappointed that we are not able to present our views in person. However, you should understand that we will continue to vigorously pursue the question of open access for the Ports of Philadelpia and we feel that the committees of Congress and the Justice Department should move ahead promptly in granting us the assurance that open access will be provided for the Ports of Philadelphia rail service.

Thank you very much for your attention to this important matter.

Sincerely,

W. A. Harrison

William A. Harrison
Executive Director

WAH:mfm

The CHAIRMAN. Mr. Falvey.

We will put all of your statements in the record, if that is agreeable, and we will give you 5 minutes.

STATEMENT OF A PORTS PANEL INCLUDING PATRICK J. FALVEY, JR., ASSISTANT EXECUTIVE DIRECTOR, THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY, NEW YORK, NY; JOHN J. MALONE, PRESIDENT, PHILADELPHIA PORT CORP., PHILADELPHIA, PA; AND LARRY BELDNER, ON BEHALF OF DON WELCH, EXECUTIVE DIRECTOR, SOUTH CAROLINA STATE PORTS AUTHORITY, CHARLESTON, SC

Mr. FALVEY. Thank you, Mr. Chairman.

I would like the record to note that my name is misspelled. It is not F-a-l-d-e-y; it is F-a-l-v—like in "Villanova"—e-y. [Laughter.]

The CHAIRMAN. We will order the clerk to change the spelling of that word.

Mr. FALVEY. Thank you, Mr. Chairman.

Mr. Chairman, I am the assistant executive director and general counsel of the Port Authority of New York and New Jersey, and as such, I am appearing here on behalf of a port that is a captive port. Your committee has heard from captive shippers. The main thrust of our testimony is that we are a captive port, due to a structural flaw in the existing regulatory system that would only be perpetuated by the bill proposed by DOT and pending before this committee.

The port authority which I represent is an agency of the States of New York and New Jersey, charged with the development and operation of terminal transportation and other facilities of commerce in the New York/New Jersey region, and with the promotion and protection of the trade and commerce of the Port of New York/New Jersey.

As background to our main point, I want to emphasize that in fulfilling our duty, we are locked in a tough struggle with the other ports on the North Atlantic Range, including my colleagues on the panel here, in competition to be the load center for the Atlantic Range of ports. That competition arises from the technological change of huge new ships now coming into service, carrying many, many more containers, which make uneconomic many port calls. The focus will be on calls at fewer ports which will serve as load centers. We do not think that the Port of New York/New Jersey can be an effective competitor for the load center category without having effective rail service.

We have effective rail service now through Conrail, which has done an effective, imaginative, and productive job in our region. However, Conrail is a monopoly. Albeit federally sanctioned, it is nevertheless a monopoly, and the proposal before you would perpetuate that monopoly. It would involve privatization with complete immunization of the emerging private entity from antitrust laws and from ICC jurisdiction.

Now, we do not believe that the Port of New York/New Jersey or, for that matter, any other port to be served by that system, should be placed in the hazardous position of effectively having only one railroad serving that port. We believe that there should be competition. In fact, now, there is no such competition. Conrail alone serves our port, however effectively that might be, and the proposal before you would not alter that situation, but rather, it would compound the difficulty that we now have.

Our solution—and we think it is within the province of this committee to recommend that—is that whatever legislation is passed include a feature whereby other railroads could fairly compete with the new system through obtaining trackage rights through mechanisms that could fit within the jurisdiction of the Interstate Commerce Commission or even through the special court during the transitional period.

Without that feature being included in the legislation, my port agency would respectfully have to oppose any of the proposals that have been discussed to date.

As a matter of fact, it is relevant to this Committee's inquiry. We have had many discussions with both Conrail and the Norfolk Southern people, and we are not satisfied that any of the proposals that have been discussed, including the competitive bidding and the public sale option, really offer the port a competititive advantage. Now, that, plus the fact that the legislation would perpetuate the captive status of the port, leads us to recommend that this committee earnestly consider rectifying the captive status of the ports served by these railroads, and perhaps request the Justice Department to include in its competitive analysis of the proposal the status of the captive ports and ways and means to alleviate that situation.

The CHAIRMAN. You would prefer, as I understand, for it to stay like it is, Conrail?

Mr. FALVEY. Not necessarily. We could not tolerate the present position, whereby no other railroad can effectively compete for the Port of New York/New Jersey traffic. We think that has to be changed.

Conrail has been a benevolent monopoly—my time is up.

The CHAIRMAN. Thank you very much.

[The following was received for the record:]

STATEMENT OF PATRICK J. FALVEY, ASSISTANT EXECUTIVE DIRECTOR/GENERAL COUNSEL OF THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY

My name is Patrick J. Falvey, I am the Assistant Executive Director and General Counsel of The Port Authority of New York and New Jersey. The Port Authority is an agency of the States of New York and New Jersey and is charged with responsibilities that include the development and operation of terminal, transportation and other facilities of commerce in the New York/New Jersey region and with the promotion and protection of the trade and commerce of the Port of New York/New Jersey. Our concerns in discharging these responsibilities have compelled us over the years to participate actively in legislative hearings before Congress regarding legislation affecting transportation to and from our Port and, where necessary, we seek relief before administrative agencies. The Port Authority therefore for many years has been involved in federal level railroad issues as they affect or might affect our Port of New York and New Jersey District.

Our agency was created as a means of resolving some of the railroad rate and other disputes that existed prior to World War I involving the then 12 major railroads that served our Port. These rail disputes resulted in the now famous New York Harbor case of 1917 out of which stemmed a Bi-State concord to form an agency which would work to harmonize the interests of the communities on both sides of the New York harbor. While the structure and nature of rail service to our Port has changed dramatically since the creation of the Port Authority in 1921, certain issues continue to arise which require Port Authority intervention. One such issue is that railroads serving the Port of New York have tended to favor competing ports and thereby unfairly divert cargo away from the Port of New York/New Jersey. This concern in the 1960's led to an action that finally resulted in a decision of the Supreme Court of the United States in 1963 equalizing rates between all North Atlantic ports and the mid-west for freight moving in conventional rail cars.

The Port Authority has similarly vigorously attempted to fulfill its duty to protect the commerce of the Port during the current era when as a result of the major railroads serving the area going under, Conrail was created through legislation passed by Congress. We continue to be watchful and protective of our Port's competitive position; notwithstanding the fact that Conrail, the sole remaining major railroad in our area, appears to be prospering financially and has provided good service to the Port. New York/New Jersey is Conrail's number one port and Conrail is effectively our only major railroad. We thus have a vital interest in the future of the Conrail system.

While the large majority of Conrail's traffic base is comprised of domestic shipments, import/export traffic nonetheless is quite significant and, in fact is a growing share of the region's rail activity. Our Port was the first to introduce the innovation of containerization in the early 1950's, but today we must compete intensely for this traffic with other ports for cargo going to and from the midwest, as to the traffic which originates from or is destined to those points which are the hinterland of a number of ports including the Port of New York and New Jersey. Better rail service to our Port facilities is an integral element in our campaign to maintain the Port of New York/New Jersey as the ocean shipping load center on the East Coast. As the larger ships, now coming into service, are carrying over 4,000 20-foot container equivalents, there will be calls at fewer ports. The focus will be on calls to center, with non-load center ports being served by truck or barge. Cost-effective inland rail transportation is a necessary ingredient in positioning a port so that it can attract business from steamship companies and shippers in a cost-driven deregulated environment. Because of the Shipping Act of 1984, rail service will become increasingly competitive with truck, with the result that it should become an even more important factor in port selection.

Much is at stake in this initiative since the port industry accounts for some $14 billion in economic activity, $4.2 billion in wages and $500 million in state and local income and sales taxes. It directly and indirectly generates almost 200,000 jobs in the New York/New Jersey region, with a regional employment impact almost equivalent to that.

Our load center strategy is driven by the need to lower costs, particularly in light of further deregulation and the resulting increase in competition between ports. This initiative includes terminal modernization, harbor dredging, adequate storage capacity, and improved access to inland transportation. The Port Authority is prepared, througn our Bi-State Port Plan, to meet this responsibility by making the investment of some $400 million that will be required. In addition to facility investments, the Port Authority is actively working to reduce costs in other ways such as our extraordinary action before the Federal Maritime Commission to work out a more acceptable arrangment on tonnage assessments for longshoremen's fringe benefits that had disadvantaged our Port in the pricing of through container movements. We are extremely hopeful that efforts like this will further strengthen our competitive position.

As we prepare the Port for the new era of large container ships, deregulation, and increased port competiton, we face significant potential changes in what has been recently a generally good and productive relationship with Conrail. Conrail's port services are far superior to a decade ago. Our Port suffered terribly from poor service in the final years of Conrail's bankrupt predecessors and, at all costs, we want to avoid that kind of disservice again in our rail network. Conrail Chairman Stanley Crane and his staff deserve substantial credit for the turnaround and the excellent reliability, frequency and transit time of Conrail's intermodal operations. Nonetheless, much still needs to be done and we will be seeking even more in the future in innovative and attractive rates and services from whomever succeeds Conrail.

In light of what is at stake, and because of inadequate information relating to what the specific plans and intentions of the various parties are, we see no advantages to our port - nor do we see a necessary urgency for immediate sale - for any of the options to take over Conrail. Neither do we see a consensus among shippers at this point. We have concluded that the vital economic interests of our region require that any options involving Conrail must be able to demonstrate:

1. a long-term strategic commitment to staying in the railroad industry;
2. adequate corporate financial resources and managerial ability to weather future downturns in the economy;
3. a management commitment to innovative marketing, especially in the export/import business;
4. a long-term commitment not to break up or sell off the railroad, Conrail already has had adequate opportunity to trim unproductive lines and increase plant productivity;
5. a commitment to restrict dividends, if necessary, so as to continue the high level of investment in physical plant and equipment;

6. an openness to competitive options which do not unduly threaten the railroad's viability and which are of clear benefit to shippers;

7. a continued commitment to the marketing and growth of rail intermodal traffic, the segment of the region's rail market which is growing most quickly; and,

8. a commitment to honor current agreements, understandings and working relationships between the Port Authority and Conrail.

In addition, with respect to import/export traffic, we still insist on the following:

1. a commitment that the rate charged is consistent with the rate at the railroad's other ports, using conventional piggyback equipment;

2. a commitment to encourage growth of the Port of New York/New Jersey through innovative pricing schemes, including giving lower rates to high volume shippers;

3. a commitment to further encourage growth of import/export traffic by introducing innovative new services and technologies, such as double-stack cars, designed to capitalize on our Port's high volume of container traffic and excellent rail access and clearances; and,

4. a commitment not to favor another port or to unfairly cause a diversion of traffic from the Port of New York/New Jersey through rate settings and services, for reasons other than demonstrable economic, business factors.

It is because our Port is captive to Conrail, regardless of who controls that railroad, that we must seek these commitments.

The unique status of the Port of New York/New Jersey must be evident to members of this Committee when they consider the fact that unlike the other ports that are represented here today, our Port, for all practical purposes, is subject to an existing railroad monopoly and that rail freight entering our Port enters on only one major railroad. Because of the economic dislocations that resulted in the demise of the once flourishing competing railroads that served the Port and as a result of Congressional action in recent years, the Port of New York/New Jersey now exists under the penumbra of a dominant railroad. While the exercise of that monopoly power upon our port facilities in recent years has been largely benign, the fact remains that ours is a captive port.

The Regional Rail Reorganization Act of 1973 (The 3R Act), created Conrail as a "for-profit" corporation which would acquire and operate any rail properties which might be conveyed to it pursuant to the "Final System Plan." This same legislation created the United States Railway Association (USRA) and charged it with the mandate to prepare the final system plan for the reorganization of the bankrupt northeast rail lines. This reorganization was freed by statute from the normal oversight and constraints that were formerly placed on railroad mergers and acquisitions for the protection of the public. Specifically the implementation of the Final System Plan was granted immunization from the Interstate Commerce Commission (ICC), the anti-trust laws, the Bankruptcy Act and the National Environmental Policy Act. While a Rail Service Planning Office was established within the ICC to assist the USRA in certain of its functions, the ultimate authority to draft and submit the Final System Plan rested with the USRA and not the ICC. While it is clear that the goal of the 3R Act was not to create a monopoly in the northeast, unfortunate circumstances resulted in that occurring.

The Final System Plan which was submitted to Congress in July, 1975, provided for certain property formerly held by the Penn Central and other smaller bankrupt railroads to be taken over by Conrail. Significantly, the Plan also provided for the expansion of a competing railroad in the New York metropolitan area through the absorption of certain lines of the Erie Lackawanna and Reading railroads. Unfortunately, because of the inability of that carrier to negotiate satisfactory labor agreements the opportunity to acquire those lines was declined. The result was that a rail carrier was created to serve the northeast with no effective competition to serve the Port of New York/New Jersey.

Since the passage of the 3R Act in 1973, other legislation has been enacted by Congress, such as the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act), the Staggers Act and the Northeast Rail Service Act of 1981 (NERSA). All of this legislation impacted to some extent on the regulation of railroads and the ability to compete in the northeast. Many of the regulatory policies that were set forth in the 4R Act were carried forward and expanded in the Staggers Act, or what is sometimes referred to as the Railroad

Deregulation Act. Included in the policy statement of the 4R Act is a declaration that "the policy of Congress in this Act is to foster competition among all carriers by railroad and other modes of transportation services ..." The Staggers Act was equally dedicated to the precept that competition is the best regulator. Unfortunately, in spite of statements by the Port Authority expressing concern at the absence of competition in our region, the Staggers Act was passed without effective captive-port protection. While our region is now enjoying relatively efficient rail service, the specter of our sole rail carrier being controlled by a railroad system that may have its focus on other ports causes us continuing intense concern. As an example, a rail monopoly, which does not face effective rail competition might be encouraged to raise prices and defer new investment in the port where it has a monopoly because it must concentrate services/improvements and adjust its prices to remain competitive in those other ports where it must face competition.

Apparently, we are not alone in expressing concerns about the erosion of effective competition that might be caused by an acquisition of Conrail. The Justice Department in its letter to Secretary Dole dated January 29, 1985, addressed certain competitive problems that it identified as arising from the proposed sale of Conrail to Norfolk Southern. The competitive analysis undertaken by the Justice Department unfortunately focused only on those geographic areas where competition now exists and which may be denied competition as a result of an acquisition and merger. Because of the narrow focus of this inquiry, no consideration was given by the Department of Justice to the monopoly that presently exists in the Port of New York/New Jersey and the possible exacerbation of this problem that may be caused by the proposed acquisition.

The analysis done by the Department of Justice focuses on post-merger concentrations not previously existing which result from the merger. Only those markets were considered in which the merger may have a significant adverse impact, i.e., would result in the high post-merger concentration and could significantly increase the pre-merger concentration. In short, because of the methodology employed no consideration was given to those areas where there is already a pre-merger concentration.

At this time one of the Port Authority's immediate concerns is that apparently no consideration has been given to the impact of an acquisition on a captive port such as the Port of New York/New Jersey. It is particularly disturbing that it appears that the monopoly that has been created, and will be perpetuated regardless of what option is chosen by Congress regarding the future of Conrail, is treated as an accomplished fact that need not be dealt with. To the contrary, we are convinced that avoidance of the creation and perpetuation of such a condition is a basic responsibility of the Congress for the protection of captive ports from possible market abuses by a monopoly railroad. Just as Congress has in recent years expressed its commitment to reliance on competition in lieu of regulation in the railroad industry, so it has over the years indicated that it favors to the greatest extent the free movement of export and import cargo through the nation's ports. We feel that it is imperative that the Conrail system after either an acquisition by Norfolk Southern or a public offering be structured so that it cannot arbitrarily or unreasonably inhibit the extension of services by competitive railroad systems into the Port of New York/New Jersey whenever it can be demonstrated that the economic incentive to provide such competition exists. To permit an existing monopoly carrier to inhibit competition by other carriers is clearly contrary to the spirit of the statutes that created Conrail and deregulated the railroad industry.

One solution to the problem presented is for Congress to once again express its commitment to reliance on competition and to provide in any enabling legislation a procedure by which a rail carrier can acquire, on reasonable terms, trackage rights over which to provide competing services to our Port. We think it unrealistic at this time to identify such a carrier and to demand through Congress specific authority or rights for such a carrier to enter our region, but we think it equally unwise to rely solely on the reasonableness or concessions of a dominant rail carrier whose future economic interests and the interests of its stock holders may encourage the inhibition of competing services.

Entry into a market area by a rail carrier proposing to provide competition with the dominant rail carrier in the region, can be prohibitively expensive and virtually impossible unless appropriate procedures are provided under which such a competing carrier can obtain trackage rights on reasonable terms. Because the legislation proposed by the Department of Transportation provides in Section 104 that implementation of the Secretary's plan is "deemed approved by the (Interstate Commerce) Commission under Chapter 113 of Title 49, United States Code," the Commission will not have an opportunity to consider whether the proposed transaction will have an effect on competition among rail carriers in the region, nor can the Commission use the opportunity to impose conditions to protect competition in the Port of New York/New Jersey. Instead the transactions will be exempt from anti-trust laws and all other laws including state and municipal laws, as necessary. For this reason we feel it essential that the Conrail Sale Amendments of 1985 provide appropriate conditions that will preserve the possibility and practicability of future rail service to our area.

Because of the questions that have been raised regarding the Norfolk Southern proposal, in particular the nature and extent of anti-trust immunity, the anti-competitive impacts and the potential for traffic diversion from northeastern ports, and because our past experience has taught us that legislation such as that presently being considered will affect our port for generations we urge you to act carefully and cautiously. At this time we have heard no arguments nor have we seen any evidence that the sale of Conrail to the Norfolk Southern will advantage the Port of New York/New Jersey competitively. Sufficient time must be allowed to assess potential impacts and consequences and to provide wherever possible protection for captive ports against possible market abuse by the dominant carrier resulting from the contemplated sale of Conrail.

Thank you.

The **Chairman**. Mr. Malone.

STATEMENT OF JOHN J. MALONE

Mr. **Malone**. Mr. Chairman, my name is John J. Malone, and I am president of the Philadelphia Port Corp. The Philadelphia Port Corp. is responsible for the administration, development, and promotion of the Port of Philadelphia, one of our Nation's leading international seaports.

I appreciate this opportunity to testify before the Senate Judiciary Committee on behalf of the management of the Philadelphia Port Corp. concerning the sale of Conrail and the impact it would have on the port and on the men and women dependent upon the port for their livelihood.

The Philadelphia Port Corp., after an extensive examination of all proposed options for the return of Conrail to private ownership, has concluded that the broad range of interests served by the Port of Philadelphia would best be served by a public issuance of Conrail shares now held by the U.S. Department of Commerce.

The Philadelphia Port Corp. has undertaken an extensive investigation of all options proposed for the return of Conrail to private ownership. Our overview considered not only the impact each proposal would have on the public and private interests within the port, but on those entities which rely on commerce moving via rail through the port throughout the Nation.

Based on our best judgment, the Philadelphia Port Corp. has concluded that public policy interests in trade and transportation would best be served by Conrail remaining an independent entity. Since no public proposal exists to both affect this transfer and satisfy the broad range of concerns which have been expressed, the port corporation further calls for a 6-month moratorium during which a plan for the orderly transfer of ownership to the private sector through a public offering can be devised.

Because of the financial stake the taxpayers of the United States have in Conrail, the port corporation believes, in addition to ensuring that a sufficient price is received, that Conrail's infrastructure should remain substantially intact, avoiding a broadscale selloff of trackage or trackage rights to smaller, and possibly less viable, railroads.

The Philadelphia Port Corp. calls upon the U.S. Department of Transportation, in cooperation with the Congress, to agree to a 6-month moratorium to commence at the earliest possible date, and to begin the process of structuring a public issuance of Conrail shares now held by the Department.

The **Chairman**. Thank you, Mr. Malone.

Mr. Beldner, I believe you are representing Mr. Welch here today, for the South Carolina State Ports Authority.

STATEMENT OF LARRY BELDNER

Mr. **Beldner**. Thank you, Mr. Chairman.

My name is Larry Beldner. I am deputy executive director with the South Carolina State Ports Authority, and I am representing Don Welch, the executive director who, because of other commitments, could not be here today. He has prepared a statement that I would like to read for the record.

A healthy maritime industry is essential for the well—being of this country. For that reason, I am proud of the supporting role played by the South Carolina Ports in our Nation's international commerce.

One of the oldest ports in America, Charleston retains its rich sense of history. Yet it sports facilities are some of the newest and most modern in the world.

As executive director of the South Carolina Ports, it is my responsibility to assure that we keep up with the times. Ports provide employment for thousands of people, and the products that are exported through Charleston provide work for many thousands more.

We are convinced that Norfolk Southern's acquisition of Conrail will benefit the Port of Charleston. The impact area of import-export tonnage for Charleston does include the Conrail-served States of Ohio, Indiana, Illinois, Michigan, Pennsylvania, and other Midwest points beyond. This concept of Conrail becoming a full partner of the Norfolk Southern could produce single-line rate action which today is not feasible and could provide an even more competitive transportation system than is available today.

The Port of Charleston has invested very heavily in installation of equipment to handle large, heavy-lift equipment moving in the international market. With minimum clearance restrictions in effect today on Norfolk Southern, much of the tonnage now originating on Conrail could move via single carrier to the Port of Charleston without restrictions.

Norfolk Southern's enormous financial strength should also better enable Conrail to withstand a recession, whether in 3 years, as many predict, or further down the road. This same financial strength would also permit the South Carolina Ports to establish long-range market strategies in Conrail-served States, which should prove to be of competitive value to industries and international shippers located in these States.

With the current trend of container lines establishing load centers in the North and South Atlantic, it is conceivable that a line would select one port in the North and one in the South to serve the entire Atlantic coast. For this reason, the Port of Charleston has geared up to become a front runner in the South Atlantic to attract such services.

Charleston has the most modern container facilities and handling capabilities when compared with other south Atlantic ports. With terminals located close to the open sea and with current harbor depths sufficient to handle ships now in this service, Norfolk Southern, with Conrail as a partner, could significnatly expand the potential containerized market area with the results that Charleston could become firmly entrenched as the major South Atlantic load center.

We fully expect an improvement of rail transit times and/or service on shipments invovled to and from current Conrail stations. We would also expect Norfolk Southern to streamline schedule and yard operations similar to action taken when Norfolk & Western and Southern Railway merged to create Norfolk Southern. This action would not only improve service, but should also reduce operating costs resulting in lower transportation charges to the shipping public.

After the N&W/Southern merger, we found that artificial obstacles to movement of N&W traffic, for which Charleston had the best natural and commercial advantages, were removed. Nor did we detect favoritism of Norfolk over any other port.

New markets of grain could be opened to our elevators; 8owever, this area should be addressed by the Farm Bureau Marketing Association.

Overall, we feel very positive on Norfolk Southern's acquisition of Conrail and fully support the recommendation of the Department of Transportation.

Thank you, Mr. Chairman.

The **Chairman**. Thank you very much.

Is there any other statement any of you wish to make? I think the statements explain themselves.

I want to thank you gentlemen for your appearance here. We appreciate your testimony, and all of it will be in the record. There may be some other statements to be placed in the record, so we will leave the record open for that purpose, for statements from other ports, other shippers, or perhaps other Senators or others.

This now concludes the hearing, and we stand adjourned.

[Whereupon, at 3:25 p.m., the committee was adjourned.]

APPENDIX

ADDITIONAL STATEMENTS AND VIEWS

Statement for the Record
by
Allen Housh

Vice President, Transportation
Cargill, Incoporated

Mr. Chairman and members of the Committee. My name is Allen A. Housh. I am vice president for transportation for Cargill, Incorporated, of Minneapolis. Cargill is a merchandiser, processor, warehouser and transporter of numerous bulk commodities, with operations throughout the United States and much of the remainder of the world. As such, the company has a keen interest in the development and maintenance of a sound national transportation system, particularly policy matters involving the nation's rail system. In 1983 alone, Cargill's total rail-freight bill exceeded $650 million.

That concern with sound transportation policy leads us to oppose S. 638, the Conrail Sale Amendments of 1985. While Cargill recognizes the importance of ending federal ownership of Conrail, we also fear that insufficient attention has been given to both the short-term and long-term implications of the proposed sale to Norfolk Southern. The proposed merger would lead to an immediate decline in number of competitive rail alternatives for many shippers. But of perhaps greater importance, the proposed merger would hasten a trend toward consolidation of the nation's major rail carriers and increased potential for monopolistic market power at a time when more intra-rail competition is needed to ensure the long-term success of railroad deregulation.

Rather than continue and accelerate the already precipitate drive toward fewer major U.S. rail carriers and reduced intra-railroad competition, the United States should take steps to promote competition by allowing Conrail to remain an independent force in the rail transportation marketplace. With that in mind, Cargill would prefer to see a public sale of Conrail stock rather than sale to the Norfolk Southern.

Immediate Reductions in Competition

As others testifying on this issue have pointed out, and as the Committee no doubt is well aware, the proposed merger of Conrail and Norfolk Southern poses difficult policy questions for U.S. transportation. It is important to return Conrail to private ownership and recoup as much as possible of the federal investment in the system. And it is also important to give consideration to the probability of long-term economic health for Conrail. However, neither of these concerns should take pre-eminence over the need to maintain intra-rail competition.

For a significant number of rail shippers in the areas served by the two railroads, the proposed merger would lead to a real and measurable reduction in the level of carrier competition. A consolidated Norfolk Southern-Conrail would mean one less source of the competitive discipline that polices price and service. That point is certain.

It is far less certain, however, that the divestiture of certain portions of track as proposed by the Department of Justice is sufficient to result in effective intra-rail competition. While smaller carriers are an important — indeed, integral — part of a healthy national rail system, they cannot realistically be expected to provide the same degree of head-to-head competition that is present when major railroads must fight for a common pool of freight. In my opinion, the divestiture of track under discussion at this time would not constitute the guarantee of effective competition shippers need and demand.

Similarly, the potential for increased single-line service and direct access to new markets for some shippers should be of secondary importance to the anticompetitive effects of the proposed merger. A combined Norfolk Southern-Conrail system might provide what is perceived to be improved access for some shippers to markets previously unavailable on a direct route. However, this is a small gain in comparison with the potential harm arising from reduced competition. In fact, a better, more universal guarantee of access to new and distant markets could be provided through a truly competitive rail environment, in which carriers are forced to meet shippers' needs for expanded market access. Consolidation is not the sole means of expanding market access. Competition also can serve this purpose, and can do so for a wider universe of shippers.

The Importance of Competition

This Committee and other panels of Congress have heard a long list of witnesses on this issue, including many who have raised concerns about the anti-competitive effects of the proposed merger. In order to understand the reasoning behind this concern -- and in particular the reason for Cargill's concern -- it may be useful to examine briefly the importance of competition to bulk shippers. This may help explain why shippers such as Cargill consider the maintenance and promotion of intra-rail competition to be of such overriding importance.

The presence or absence of effective competition -- and the resulting potential for monopoly market power -- have very different effects on different types of shippers. The shipper who has a high-priced, high-value, value-added consumer product by and large will ship his product from point of manufacture to market at a small fraction of the product's value. Changing freight costs may be passed on easily and often imperceptibly to the ultimate consumer.

But a shipper of low-value, high-volume commodities enjoys no such luxury. The products shipped by Cargill and many other of the witnesses opposing the proposed merger tend to be fungible, bulk, merchandised, low-value and low-margin goods. Transportation costs often represent 15 percent or more of their delivered value. Additional transportation costs are not easily passed on to the buyer. And furthermore, the disproportionate cost of moving the goods from one carrier to another make them less flexible in their shipping patterns and more captive to one mode. This leaves shippers such as Cargill highly vulnerable to monopoly freight pricing.

The adverse effects of this situation may be felt far beyond the immediate shipper. When competition is absent, reduced or ineffective, a captive facility is likely to face higher freight charges. But equally important, any savings achieved by the carrier from reduced carrier costs or increased carrier efficiency are not passed on to the carrier's customers and the general public of consumers whose welfare finally defines the public interest. When a monopoly situation permits freight charges at levels higher than they should be, the public interest is not served. Effective competition provides the essential protection against the abuse of potential market power.

This is not an abstract discussion or an issue unrelated to the specific issue at hand. The universe of businesses served by the Norfolk Southern and Conrail is large and clearly important to overall U.S. economic interests. Cargill, for example, operates more than 60 facilities in the East and Midwest located on Conrail, Norfolk Southern or open to reciprocal switching to Conrail or Norfolk Southern (see attached listing). These facilities include grain elevators, flour mills, corn processing mills, molasses terminals, feed mills and depots, salt mines and terminals, as well as steel mills, storage facilities and related installations. The level of effective available competition to shippers served by these railroads is of major importance, both to the companies involved and the larger, national economic interests these various businesses compose.

Long-Term Concerns

The potential immediate adverse effects of the proposed merger on direct competition alone are sufficient to lead Cargill to oppose S. 638. However, there are perhaps even more troubling questions in my mind about the longer-term implications of a Conrail-Norfolk Southern merger. Simply stated, those questions involve the effect of this and other mergers of major rail systems on rail deregulation.

I am concerned that inattention to the effects of recent rail mergers on competition could undermine the success of the Staggers Rail Act of 1980 and lead to calls for reregulation of the nation's rail industry. Cargill emphatically supports rail deregulation and opposes efforts to re-institute the rigid government guidelines that for years stifled railroad innovation and profitability. Since passage of the Act, shippers and carriers have made remarkable progress toward building a leaner, more efficient, more responsive and service-oriented, profitable rail system. But the successes associated with the Staggers Act should not blind us to the potential damage that a decrease in rail competition could inflict upon deregulation.

When Congress passed the Staggers Act, it clearly stated that regulation could be replaced only by a competitive rail environment. That is, the incentives of the marketplace would foster the innovation and service lacking under regulation. Competition, not government, would police the industry and protect against monopoly power.

Additional provisions of the Staggers Act were designed to protect those shippers captive to single railroads from abuses of market power arising from the lack of direct competition. However, these protections also have been emasculated by the Interstate Commerce Commission. The agency's liberal interpretation of the applicability of product and geographic competition in market dominance determinations, for example, and its pre-occupation with placing rail revenue-adequacy goals ahead of other considerations, have left shippers without an effective means of remedy for the abuse of rail monopoly power.

To compound the problems facing the shipping community, the basic protections afforded by competition are being eroded through inexorable merger activity. In the past 10 years, at least seven major merger applications have been processed or are underway at the Interstate Commerce Commission. The number of Class I railroads has diminished significantly --so much, in fact, that today 75 percent of the industry's route miles and 85 percent of its operating revenues are controlled by only seven railroads. Many experts warn that the number of Class I carriers may fall even further by the end of the century -- perhaps to only four or five carriers.

Much of this merger activity has been allowed to proceed without adequate consideration to its effects on rail competition. Like the proposed sale of Conrail to Norfolk Southern, other "larger" concerns have been given greater importance and accorded higher priority. Most often, the argument involves "increased efficiency" or "maintenance of a viable rail system," or "improved profitability."

Making Competition a Priority

At some point, however, it becomes important to say "far is enough." At some point, we must realize that the logical end to this argument is a handful of major rail systems and an end to the effective competition that underlies and forms the basis for our current policy of rail deregulation. If we are to maintain a market-oriented, self-sustaining rail system, we must stop making the preservation and enhancement of competition a stepchild to other concerns. The need for guaranteed levels of profitability or greater efficiency must be balanced against the paramount need for intra-rail competition.

In recent years, we have tended to overlook the importance of competition. Many members of the railroad industry note quite correctly that rail rates generally have declined under deregulation, thanks to the greater operational efficiencies earned under the Staggers Act. However, it is a mistake to assume these declines are prima facie evidence that effective competition is present and working among all rail carriers, and it is a mistake to neglect competitive concerns on this basis.

In many cases, the rate declines also mirror the reduced demand for service that accompanies poor economic conditions. The grain industry is one example. Many rail rates for grain shipments have in fact declined since the passage of the Staggers Act. But at the same time, export demand has fallen by more than 700 million bushels.

As economic conditions improve for shippers and transportation markets strengthen, the importance of competition will become more visible. But we cannot afford to wait for that turnaround before we rethink our approach to rail mergers. If we allow the railroad industry to grow ever more concentrated in the interim, we will find it very difficult and perhaps impossible to restore the competitiveness to the system. We all would acknowledge that a decrease in the number of rail carriers brings with it an increase in the risk for monopoly power. We now must also acknowledge that once gone, major railroads cannot be recreated. Competition, once lost, cannot be easily restored.

The Immediate Problem

These concerns have been obscured in this debate for two primary reasons. One is the desire to recoup the federal taxpayer's investment in Conrail through prompt acceptance of Norfolk Southern's firm offer of $1.2 billion. The second is the fear that Conrail could not survive without the financial backing of a rail system with the expertise and financial strength of Norfolk Southern. I believe the maintenance of Conrail as an independent system is of sufficient importance to override these concerns.

There is adequate evidence to believe Conrail could survive as an independent railroad. I will leave an evaluation of the recent staff report on the subject by the United States Railway Association to the evaluation of Congress. Instead, I would point to other considerations.

First, the economic and regulatory conditions facing Conrail in the 1980s are appreciably different from those of the 1970s. The economy is stronger and generally improving. And more important, the Staggers Act has ended many of the regulatory limitations on railroads' operational flexibility. Unlike the '70s, the '80s offer Conrail the opportunity to be innovative, to tailor service to customer needs, to streamline operations -- and to be profitable. These are important improvements.

Second, there is ample evidence that Conrail is acting to take advantage of these freedoms. Conrail has reduced unprofitable operations. It has grown leaner and more efficient. Its management has been among the most innovative and aggressive in the entire industry. And its bottom line reflects the operational and managerial improvements. After nearly five years of experience under deregulation, Conrail has proven itself to be a capable player in the railroad marketplace.

On this basis, I believe the issue of a public sale deserves additional consideration. There is more at stake in this issue than the recapture of federal dollars.

Reject S. 638

I would like to conclude my statement by repeating my initial position on the legislation before the Committee. S. 638 should not be enacted.

Many members of Congress have been appropriately critical of the ICC for its failure since 1980 to give proper weight to the preservation of adequate levels of competition among railroads as mandated by the Staggers Act. It would be tragic now for Congress to fall into the same trap for pragmatic reasons. It would send a most unfortunate message at a critical moment in transportation history to both the Commission and the courts that must administer the Staggers Act. That message would be that Congress does not think the preservation of adequate competition among railroads is all that important, either.

Such a message would be the beginning of the end for this promising era of rail deregulation. Absent adequate rail competition, the Staggers Act ultimately will fail. Then, reregulation or nationalization will be the sole remaining options. It is as simple as that.

I recognize the complexity of the task facing Congress and the administration regarding the proposed merger of Conrail and Norfolk Southern. The government must balance enormous political pressures and practical considerations favoring the merger against the need for a competitive rail policy with benefits that are both difficult to quantify and at present largely unrecognized. But I would urge you to give greater attention to the importance of rail competition for all rail shippers nonetheless.

Thank you for the opportunity to offer this statement.

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STATEMENT BY THE HONORABLE ELIZABETH HANFORD DOLE

SENATE JUDICIARY COMMITTEE

April 3, 1985

I would like to take this opportunity to highlight certain key points that demonstrate that the selection of Norfolk Southern as purchaser of Conrail is in the best interest of the Government, taxpayers, shippers, and communities now served by that railroad.

We have been extremely successful in negotiating the strongest possible financial package for the Government. The Norfolk Southern bid does not entail a preferred stock offering or any debt leveraging against Conrail's assets. The cash portion of the price is a minimum of $1.2 billion, which will be adjusted upward to account for any additional cash funds which accumulate prior to the sale. Norfolk Southern also has agreed to surrender tax benefits of $2.1 billion in net operating loss carryover and $275 million investment tax credits that Conrail accumulated under Government ownership. Relinquishing these tax benefits represents value to the Treasury, as they would otherwise remain available to shelter Conrail's income from taxes.

Furthermore, Norfolk Southern has agreed to be bound by a far-ranging set of restrictive covenants and contractual obligations that will safeguard the public interest during Conrail's transition to private ownerhsip. These covenants, which are enforceable in Federal court by injunction, are spelled out in detail in the Memorandum of Intent.

These tough covenants are very strong protection for shippers and communities against such hazards as the elimination of economically viable service, underinvestment or disinvestment, failure to maintain tracks and equipment, or the route structure and assets being "cherry-picked." Under our sale plan, Conrail will remain a cohesive entity continuing to provide quality rail service.

Concerning systemwide employment, Norfolk Southern has, from the outset, made clear the implications of its offer. The Norfolk Southern offer would affect a maximum of 1,800 employees, no more than 25 of whom would be associated with the Philadelphia headquarters. It would also, however, produce new hirings, on both the combined system and the divested lines, which could total as many as 600, thus resulting in a net employment impact of 1,200. Numbers ranging from 1,200 to 1,800 are well within the average annual attrition rate of the Norfolk Southern-Conrail systems, which total approximately 5,000 employees. And Norfolk Southern has guaranteed six years' full salary to any employee affected by the merger but not covered by attrition.

I would like to emphasize that a financially strong Conrail gives the greatest assurance of steady rail employment, as well as stable and reliable service to shippers. A financially weak Conrail gives the greatest assurance of declining rail employment.

On the issue of competition after a sale, the Department of Justice has taken the position that a purchase by Norfolk Southern cannot be permitted to have significant adverse effects on the competitive alternatives of shippers in the Conrail region. At certain locations where the merger would reduce shippers' options from three railroads to two, or from two to one, a new market entrant must be able to provide viable rail service so that shippers, post-sale, would still have the same number of competitive options from which to choose.

The Justice Department has identified those markets in a combined Norfolk Southern-Conrail system where shippers' options could or would be reduced, and specified how those problems must be resolved. Norfolk Southern has accepted that prescription and is actively engaged in negotiating the divestiture of Norfolk Southern lines to bring new, strong entrants into each region where a Norfolk Southern-Conrail merger would reduce competition. On February 25, for example, Norfolk Southern informed me that it had reached an agreement in principle with Guilford Transportation Industries and the P&LE to divest approximately 1,700 miles of track in the Northeast and Midwest. This agreement is the first step in satisfying conditions set forth by the Department of Justice. This agreement will help preserve and strengthen competitive shipping in Conrail's region of service, extending from Buffalo, New York, through Pennsylvania, Ohio, Michigan, Indiana and Illinois, to St. Louis.

In this regard, when the final divestiture plan has been fully developed, the Department will be submitting it to Justice for approval. The Department of Justice set out requirements and, until those requirements are met, no final action on Conrail can or will proceed.

Thank you for the opportunity to express my views on Conrail.

Cooper
TIRES

THE COOPER TIRE COMPANY
A DIVISION OF COOPER TIRE & RUBBER COMPANY
FINDLAY, OHIO 45840
PHONE (419) 423-1321

1985 APR -2 AM 11 08

April 2, 1985

The Honorable Strom Thurmond, Chairman
Senate Judiciary Committee
224 Dirackson
Senate Building
Washington, D. C. 20510

Dear Senator Thurmond:

Since I am unable to be present at the hearing of the Senate Judiciary Committee on April 2, 1985 dealing with the proposed sale of Conrail, I respectfully submit the following written testimony on this most vital topic which concerns virtually all of the major manufacturing companies in the United States.

As General Manager of Traffic and Transportation for Cooper Tire & Rubber Company, a manufacturer and marketer of tires for the replacement market in the United States, I have been either directly related to or totally responsible for our transportation for the past eighteen years. Therefore, I feel I am qualified to offer my testimony to this Committee.

Cooper Tire & Rubber Company with 1984 net sales of 555 million dollars is not considered a "major" company within the tire industry, but in relation to the transportation industry, we are considered an important user of transportation services.

Our distrubution system is strategically dispersed within the forty eight contiguous states and our market efforts cover all of the United States plus several foreign countries. Each of our distribution facilities and each of the seven manufacturing plants that make up our company utilize the services of rail companies as well as national and regional truck carriers. Five of our manufacturing plants and five of our distribution facilities are located in states East of the Mississippi River and are also located within the geographic area serviced by the Norfolk & Southern Railroad Company and Conrail. For this reason, our company is vitally concerned with the future viability of the railroad system within the eastern half of the United States.

Cooper Tire & Rubber Company has been a customer of both Conrail and The Norfolk & Southern for many years. We have found The Norfolk & Southern to provide good transit service at competitive rates and be rate receptive. They have, on many occasions, provided us transit service that did not fall within their normal service standards. Examples are: late or early switching; Saturday switches; expediting cars; etc. They have filed new rate levels that have helped to keep us price competitive in many market areas. The Norfolk & Southern has repaired Conrail tracks and spotted

Norfolk & Southern boxcars for Cooper on Conrail tracks; boxcars that were originally ordered from Conrail. Our relationship with The Norfolk & Southern has been one of mutual cooperativeness leading to growth for both companies. This attitude of cooperativeness until very recently was not displayed by Conrail.

The Norfolk & Southern is a railroading company that has proven they can generate a satisfactory rate of return on railroad operations. They have the financial stability to operate over this new additional trackage. I feel they are committed to a long-term railroad operating company, a commitment that is an unknown factor at present with the other two possible purchasers.

For the reasons outlined above, I would like to provide our support for the purchase of Conrail by the Norfolk and Southern Corporation.

Sincerely,

THE COOPER TIRE COMPANY

Ronald Lee

Ronald Lee
General Manager
Traffic and Transportation

RL:r

cc: Ken Starling

March 25, 1985

'85 APR -1 PM 4:47

The Honorable Senator Strom Thurmond
Senate Judiciary Committee
Room 224 Dirksen Building
Washington, D.C. 20510

RE: Acquisition of the Consolidated Rail Corporation
by the Norfolk Southern Corporation

Dear Senator Thurmond

This letter written on behalf of Coastal Lumber Company of Weldon North Carolina is to request the opportunity to make an oral statement in opposition to the Acquisition of the Conrail System by the Norfolk Southern Corporation at the hearing scheduled in Washington D.C. on April 2nd, 1985.

Coastal Lumber Co. is concerned with the grave effects we in all probability would experience due to the anticompetitive aspects of the proposed purchase of Conrail.

Our company now engages in the sale of forest products from origins within the South to destinations within the service area of Conrail. Our dollar volume on this traffic is approximately two million dollars annually. This traffic originates on carriers other than those operated under the Norfolk Southern Corporation.

Should the Norfolk Southern Corporation be allowed to purchase the Conrail, it would open a great number of origin points in the South to single line traffic destined to points within the present Conrail territory. Further, single line rates would be applicable as well as a competitive edge on service since those shippers not direct on Norfolk Southern origins would be at their mercy under joint rate negotiations as well as expeditious interchange service at Potomac Yard.

Clearly, it would be in the best interest of the Norfolk Southern Corporation to promote traffic from their origins as opposed to interline origins. Their direct origins generate 100% of the revenue for the Norfolk Southern and interline revenue has to be shared on a prorate split with the origin carrier or carriers.

In this light, as our company is generating all of its' Conrail destined traffic from cities other than Norfolk Southern origins, we would be placed in an extreme competitive disadvantage with those companies located direct in Norfolk Southern territory. Certainly, the Norfolk Southern would promote its' direct traffic over its' interline traffic which would result in a major loss of market share for our company. This loss of market would have a very serious economic impact on our company and could result in a number of job losses.

For these reasons, we ask for the opportunity to be placed on the docket and allowed to make a statement of our position at the hearing scheduled for April 2nd. Should this not be possible, we would request that evidence given in this letter expressing our opposition to the purchase of Conrail by the Norfolk Southern Copporation be used as our written statement of opposition.

Very truly yours
COASTAL LUMBER COMPANY

R.P. Phillips, Jr.
Manager Corporate Transportation

Our return address is:

Coastal Lumber Company
P.O. Box 829
Weldon N.C. 27890

STATEMENT FOR THE RECORD

STATEMENT BY: R. A. GALE
GENERAL TRANSPORTATION MANAGER
INTERNATIONAL MULTIFOODS CORPORATION
MULTIFOODS TOWER
BOX 2942
MINNEAPOLIS, MINNESOTA 55402

It is my understanding that the U.S. Senate Committee on the Judiciary is considering the disposition of Conrail (Consolidated Rail Corporation).

As a shipper on Conrail International Multifoods has a vital interest in the future of this railroad. Conrail serves four of our major facilities located at Baldwinsville, Buffalo and Lockport, NY and Columbus, OH. This means we have a special relationship with Conrail as a major serving carrier who has and continues to meet our day-to-day needs as well as long-range needs.

One of our primary concerns over the years regarding Conrail and its future has been that it remain an independent entity physically structured as it is today. Ironically, the proposed sale to the Norfolk Southern would apparently require that parts of the present railroad be portioned out to regional carriers. Such a plan would break up a system that has proven to be quite effective as it is presently structured.

Our experience as a customer of Conrail has been one of an effective partnership with a well-managed, innovative and efficient railroad. The management at Conrail has demonstrated an ability to be responsive to the needs of its customers and the market place and translate this into a profitably run railroad.

My Company supports the continued operation of Conrail as an independently run railroad and, to the extent the proposal by Conrail management would achieve this goal, we support the public offering proposal made by Conrail management.

By: ______________________
R. A. Gale, GTM
International Multifoods Corporation